DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR ROMANIA

As approved by the Board of Directors on 12 December 2005

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ABBREVIATIONS

APD	Romanian Pro Democracy Association
ANRC	National Regulatory Authority for Communications
AVAS	Authority for State Assets Recovery
BCR	Banca Comerciala Romana SA
BEEPS	Business Environment and Enterprise Performance Survey
BSE	Bucharest Stock Exchange
CCF	Country Cooperation Framework
CEB	Central and Eastern Europe and the Baltics
CEC	Casa de Economii si Consemnatiuni (Romanian Savings Bank)
CEO	Chief Executive Officer
CIS	Commonwealth of Independent States
CFO	Chief Financial Officer
CNVM	National Securities Commission of Romania
COE	Council of Europe
CPC	Campaign for a Clean Parliament
CPI	Corruption Perceptions Index
DA	Truth and Justice Alliance
DP	Democrat Party
EAP	Environmental Action Plan
EIA	Environmental Investigation Agency
EIB	European Investment Bank
EIU	Economist Intelligence Unit
EMU	European Monetary Union
ESCO	Energy/Efficiency Services Company
EU	European Union
FDI	Foreign Direct Investment
FIs	Financial Institutions
GDP	Gross Domestic Product
GEF	Global Environmental Facility
GNI	Gross National Income
HGV	Heavy Goods Vehicle
IAIS	International Organization of Insurance Supervisors
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IFIs	International Financial Institutions
ILO	International Labour Organization
ISPA	Instrument For Structural Policies For Pre-Accession
IMF	International Monetary Fund
IMO	International Maritime Organization
IOSCO	International Organization of Securities Commissions
JASPERS	Joint Assistance for Preparing Projects in European Regions
JI	Joint Implementation
JSC	Joint Stock Company
MCIT	Ministry of Communications and Information Technology
MEI	Municipal and Environmental Infrastructure
MELF	Municipal Environmental Loan Facility
MFI	Microfinance Institution
MIGA	Multilateral Investment Guarantee Agency
MSEs	Micro and Small Sized Enterprises
MSMEs	Micro, Small, and Medium Enterprises
MUDP	Municipal Utilities Development Programme

MWEP	Ministry of Environment and Water Management
NAR	National Administration of Roads
NATO	North Atlantic Treaty Organization
NBFI	Non-Bank Financial Institutions
NBMFIs	Non-Bank Microfinance Institutions
NBR	National Bank of Romania
NCCD	National Council for Combating Discrimination
NGOs	Nongovernmental Organizations
ODIHR	Office for Democratic Institutions and Human Rights
OECD	Organization for Economic Co-operation and Development
OPCOM	Romanian Electricity Market Operator
OSCE	Organization for Security and Co-operation in Europe
PIP	Public Information Policy
PNL	National Liberal Party
PPP	Purchasing Power Parity
PPP	Public Private Partnership
PRTR	Pollutant Release and Transfer Register
PSD	Social Democratic Party
PSP	Private Sector Participation
PUR	Romanian Humanist Party
Q	Quarter
RASDAQ	Romanian Over-the-Counter Share Market
SAPARD	Special Pre-Accession Programme for Agriculture and Rural Development
SAMTID	Small and Medium Towns Investment Development Programme
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
SEE	South-Eastern European countries
SMEs	Small and Medium Sized Enterprises
SMM	Small and Medium Municipalities
TAM	Turn-around Management
TC	Technical Co-operation
TFP	Trade Facilitation Programme
UDMR	Democratic Union of Hungarians in Romania
UNCITRAL	United Nations Commission on International Trade Law
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNOPA	National Union of the Organizations of Persons Affected by HIV/AIDS
UNICEF	United Nations Children's Fund
USAID	U.S. Agency for International Development
US$ or USD	United States Dollar
VAT	Value Added Tax
WB	World Bank

EXECUTIVE SUMMARY

Romania continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Driven by the goal of EU membership in 2007, Romania has made considerable progress in transition with 70 per cent of economic activity in private hands, advanced price liberalisation, an open foreign trade regime and significant advances ongoing in the gradual opening of key markets such as energy and in the reforms of the banking sector and infrastructure. It also continued to improve legislation in the area of corporate governance by introducing new mandatory voting requirements for publicly held companies. The parliamentary elections in November 2004 and the presidential ones in December 2004 resulted in a pro-business government committed to EU accession and to the furthering and deepening of economic reforms. President Traian Basescu appointed Calin Popescu Tariceanu, leader of the opposition centre-right party as Prime Minister, to lead a coalition government. The government has made the accession to the EU and the fight against corruption its top priorities.

Progress towards reaching the standards of a market economy has been recognised by the Bank in its annual exercise of monitoring structural reforms developments in its countries of operation. Following the many positive steps taken by the government to improve the business environment and its efforts to listen to the concerns of investors, businesses have noticed improvements in the areas of access to finance, macroeconomic stability and a large decrease of the cost of doing business between 2005 and 2002. In other areas improvements have not yet been perceived. This is due mainly to delays and/or ineffectiveness in the enforcement of some new laws and regulations. The functioning of domestic markets is not yet at the level of well running market economies. As highlighted in the 2005 Comprehensive Monitoring Report of the European Commission on Romania, corruption remains a key problem affecting the functioning of the economy.

Economic growth has been strong but is likely to moderate in the run-up to EU membership. Its drivers have shifted from investment towards private consumption, which is fuelling an import boom. Reducing direct taxation, liberalising the capital account and introducing a formal inflation targeting regime pose new monetary and fiscal challenges. Currently these challenges are not being met by an appropriate set of economic policies. This is resulting in widening domestic and external deficits, a state sector starved of funds for major social sector reforms and investments in infrastructure, and has already produced a partial loss of the competitiveness gains achieved in previous years. To improve competitiveness and attract higher FDI, which is necessary to cover an increasing current account deficit, the authorities will need to tighten their set of economic policies and make them coherent and credible, and at the same time pursue the continuation of structural reforms. In particular, high on the agenda are the reform of the labour market; the alignment of domestic gas prices with international gas prices; and, last but not least, efforts to increase transparency and accountability in the fight against corruption.

Over the last years, Romania has managed to attract significant and steadily increasing inflows of FDI, as a result of political determination to reduce the role of the state in the economy and thanks to the relatively low labour costs experienced to-date. As privatisation approaches its final stages and the real exchange rate appreciation typical of a successful transition path is taking place, Romania needs to strengthen its ability to attract green-field FDIs, which are dependent on an improved investment climate and on the provision of a skilled and competitive labour force, within the tight framework of EU market rules.

A number of key transition challenges must be addressed to build on past efforts and enhance the competitiveness of the country:

- The business climate needs to further improve in order to attract much needed larger FDI inflows, which are expected to slow down once current large privatisations come to an end. Efforts to ensure a stable and more transparent regulatory system must be increased.

- Reform of the public administration needs to advance and the reform of the justice system needs to be effectively implemented. Efforts to increase transparency and accountability must be intensified. The administration ability to efficiently absorb EU funding remains a serious bottleneck.
- Many locally owned medium-sized companies are ill prepared for an open competitive market and will face considerable investment needs for which raising financing will be a challenge. Access to foreign currency loans for Romanian companies is likely to be constrained by the high and possibly increasing reserve requirements imposed on the commercial banks borrowing in hard currency.

As of November 2005, the Bank had made cumulative commitments of € 2.9 billion to projects helping to mobilise additional funds of € 5.9 billion for Romania. The Bank can continue to bring an important contribution to transition over the strategy period by focusing on projects addressing the above challenges and for which it remains additional.

The proposed strategy of the Bank will remain broad to ensure a balanced approach to sectoral development, in order to assist Romania in its advancement of the transition process and readiness to become an EU member. This means also a broadening of the Bank's products to be made available, such as equity, local currency funding and public-private partnership structures. The focus is to deepen and broaden the role of the private sector in the Romanian economy. Only in exceptional cases will the Bank rely on state guarantees to underpin its projects. The main operational objectives will be:

- Continue to support the **infrastructure and energy** development particularly through the transfer to private ownership and commercialisation of the energy utilities. Support the government's efforts to utilise PPP financial structures to address the investment needs in the infrastructure sector and to prioritise infrastructure development designed to address regional integration. In particular, in the energy and energy efficiency sector**,** priorities will be to provide support for the key transition challenges relating to electricity generation and distribution companies; gas production, transmission and distribution companies; oil and oil products transportation companies; and market operation, especially in the context of the SEE regional energy market. The Bank will seek to work with strategic investors interested in the privatisation of energy companies. The Bank will be active in its policy dialogue with stakeholders (regulatory bodies, government institutions, and energy companies) in order to ensure that regulated sector segments set tariffs in accordance with a transparent and formula-based methodology, independently of political interference. The creation of a Regional Energy Market in South East Europe is a priority. The Bank is ready to finance the required infrastructure and to provide credit support required to operate the electricity market and facilitate trade. The Bank will continue to explore opportunities for energy efficiency components in all its projects, particularly in energy-intensive sectors. It will consider extending credit lines for sustainable energy projects (energy efficiency and renewable energy) in combination with technical co-operation and bilateral co-financing. Also, in the municipal and environmental infrastructure sectors**,** the Bank has a strong reputation as a provider of municipal finance as a result of its work in supporting the institutional capacity, the corporatisation and commercialisation of local utilities and the decentralisation of public finances. The broadening of such high standards will be a key priority. The forthcoming regionalisation in the water sector will enable the Bank to work with existing clients to extend their operations into smaller cities. The Bank will continue to provide finance to support Accession-related projects with strong transition impact. The Bank will seek to build on existing relationships to move into new segments which will include urban transport, regional roads, municipal parking, district heating and solid waste management.
- Continue to support the private sector together with **foreign and local investors**. The Bank will continue to enhance FDI flows while also supporting local enterprises to help them expand their businesses and improve their competitiveness. The main tools the Bank will use in the corporate sector will be equity and quasi equity, LT local currency funding and commercial co-financing.

Special attention will be given to the agribusiness sector, in particular to food and food processing companies' needs. The Bank will continue its support to the improvement of the investment climate through continuing high level policy dialogue.

- Contribute to the broadening and deepening of **financial intermediation** through strengthening financial intermediaries and facilitating the availability of a wide range of financial products. The Bank will also place increased emphasis on lending in local currency and developing local capital markets

In achieving its objectives the Bank will also contribute to strengthen the administrative capacity of the Romanian public administration and local authorities to absorb both the pre- and post accession funding in close co-operation with the EU and the EIB under JASPERS (Joint Assistance for Preparing Projects in European Regions).

Finally, the Bank will ensure that all operations in Romania are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans. The Bank will continue to be a major catalyst in mobilising commercial and EU co-financing, and will co-ordinate its strategy with the EU, IMF and WB in order to optimize its transition impact.

1. THE BANK'S PORTFOLIO

Since the last country strategy approved in December 2003, the Bank's portfolio enjoyed a very strong development with 39 new operations, of which only 10 were in state sector and 38 structured on a private or non-sovereign guaranteed commercial basis. In terms of volume of commitments, the EBRD will have invested more than 875 Million over the period of 2004 and 2005.

1.1 Overview of Activities to Date

As of end-October 2005, the Bank had achieved a net cumulative business volume of € 2,803 million across all sectors (see Annexes 5A and 5B). The Bank signed to date 180 investment projects and subprojects, including allocations from 31 regional projects. The Bank approved projects have mobilised total funding of € 8,626 million. The Bank committed € 401 million in 2004. The business volume in 2005 will also be substantial with an end-year estimate of over € 450 million. The current portfolio amounts to € 1,542 million over 130 projects and subprojects, of which € 1,058 million are operating assets. The table below summarises the portfolio's development. The reflows (prepayment, cancellations and amortization) have, however, resulted in a net portfolio static at around € 1.5 Billion.

Table 1: Romania Portfolio (2003 – 2005)

Indicators	October 2003				October 2005			
	Number	%	Amount	%	Number	%	Amount	%
Total:	106	100	1,523	100	130	100	1,542	100
- of which: state sector	21	20	542	36	32	25	547	35
private sector	85	80	981	64	98	75	995	65
- of which: loans	62	58	1,272	84	82	63	1,141	74
equity	40	38	203	13	46	35	400	26
guarantees	4	4	48	3	2	2	2	0

Note: Some projects include both loans and equity. Figures are net of full repayments and cancellations. Amounts are in € millions. Includes regional projects.

The distribution of the portfolio is broad with no single sector dominating: infrastructure 33 per cent, financial institutions 30 per cent, general industry 14 per cent, specialised industries 12 per cent and energy 12 per cent. The disbursement rate is 69 per cent; the respective equity and debt share is 26 per cent and 74 per cent.

The overall quality of the Bank's portfolio is very good. Since the last strategy, restructuring work has been undertaken and the number and amount of classified projects has been further reduced. Active portfolio management policy will continue. As of end-October 2005, the average risk rating of the portfolio is better than the country risk rating. Given the size of the portfolio, the extent of impaired assets (i.e. € 7.2 million) to date is very limited (0.3% of commitments).

Finally, the Bank has been engaged in 127 technical co-operation projects amounting to € 39.2 million, targeted at preparation and implementation of infrastructure projects, banking sector support and institutional support for privatization/commercialisation (see Annex 6).

ABV and Number of Operations Annual Trend

ABV	2003	2004	2005 ytd	2005 Proj.
Million	€ 384	€ 401	€ 148	€ 475
Number*	28	27	12	28

**Note: standalone and subprojects, including regional and excluding TFPs*

1.2 Implementation of the Previous Country Strategy

The last country strategy, approved in December 2003, outlined the following strategic priorities and transition goals for the Bank:

(i) Infrastructure development including privatisation/commercialisation of public utilities in the energy and transport sectors; co-financing and improved utilisation of the EU pre-accession funds via institution building;

(ii) Private sector development, including improvement of the investment climate, level playing conditions, and completion of privatisation; and

(iii) Further strengthening of the financial sector (incl. non-banking) and SMEs.

During 2004, 27 operations were signed representing aggregate new EBRD commitments of € 401 million, compared to € 384 million and € 447 million in 2003 and 2002 respectively. All operations in 2004 were non-sovereign, contributing to improving the private sector ratio[1] from 64 per cent two years ago to 65 per cent.

In the energy sector, EBRD's involvement in SNP Petrom as an equity investor allowed the Bank to contribute to the successful completion of one of largest privatisations in the region and to participate in increasing corporate governance and business conduct. The financing of Transelectrica allowed for an increase in the electricity trading and exchange opportunities in the region through the construction of a Romanian-Hungarian transmission line interconnection. The Bank continued its support for privatisations through the recent equity investment in Romania's largest gas distributor Distrigaz Sud. Constantza Port Administration Company was one of the first public sector borrowers financed without a sovereign guarantee, and will use the funds for the construction of a new barge terminal. Based on EBRD's financing, the urban transport system was improved in Brasov, Sibiu and Arad. In addition, under the Municipal Environmental Loan Facility (MELF) framework, the Bank continued to lend to municipal infrastructure projects without sovereign guarantees in Oradea, Sibiu and Bacau.

EBRD also continued its banking and non-banking financing with special support for the local Micro, Small, and Medium Enterprises (MSME) sector with 4 dedicated credit lines channelled through banks and leasing companies. Also, the Bank developed its mortgage portfolio in Romania to € 119 million to date. The Bank financed Banca Transilvania's fast growth through two capital increases and a syndicated loan. EBRD continued its support for the privatization of Romania's largest bank Banca Comerciala Romana through its equity shareholding which formed the basis for enhancing corporate governance and risk management, while also undertaking a wide-ranging review of strategy and operations. Wienerberger's greenfield investment for the construction of a brick factory brought modern technologies into the sector, increased quality and reliability and transferred technical and managerial skills and know-how.

The Bank has worked with Mittal Steel Galati (formerly known as Ispat-Sidex) on a plan to come into compliance with EU accession criteria for integrated pollution control. Mittal made a preliminary assessment in 2004 and obtained 18 months (i.e. July 2006) for the development of a detailed programme to meet EU standards. For other projects, such as Terapia and Petrom, the Bank is closely monitoring the implementation of environmental action plans to clean up past liabilities.

In the ten months of 2005, the Bank signed 12 projects amounting to € 148 million in sectors such as energy, municipalities, banking and non-banking financial institutions, and real estate, the majority in the private sector.

[1] As defined in the Board Document BDS92-101 (Final)

1.3 Transition Impact of the Bank's Portfolio and Lessons Learned

The Bank has financed a considerable number of projects to support private sector development in banking, power and energy, natural resources, telecommunications and general industry. Through these investments, and the direct involvement of Bank representatives in the Executive Boards of a large number of investee companies, the Bank has succeeded to improve corporate governance practices and to enlarge the policy dialogue.

The Bank had significant Transition impact in the energy sector through the transparent and high international standard of the privatisation of Petrom, Distrigaz Sud as well as the financing of the Romanian Hungarian Transmission line based on a structure without state guarantee to a public sector company. In the infrastructure sector the transition achievements were very high by providing finance on a non-sovereign basis to the state company Constanta Port and to 3 municipalities for their investments in urban transport projects. In the banking sector the Bank provided further facilities like mortgage loans, leasing facilities and created a new municipal facility for banks to support smaller municipalities to cover their investment needs but also to provide technical assistance to improve their implementation and monitoring capabilities. In the corporate sector FDI was attracted and corporate standards improved. Further more the Bank has been instrumental in monitoring the commitments of investment projects like Mittal, Terapia and Petrom to meet EU environmental and health standards according to an agreed Environmental Action Plan.

Valuable lessons related to co-ordination with and between various government bodies, monitoring of TC funding, corporate governance and turnaround, management and debt absorption capacities of public entities have been learned. The Bank will build on this experience to further strengthen co-operation between Romanian authorities and the business community, so as to capitalise on the lessons learned from the past and support the restructuring and modernisation of the remaining companies due for privatisation.

The Bank's experience in Romania has provided lessons to be considered for future operations (see details in Annex 8):

- Reform of the economy depends on political willingness and determination.
- Dedication and experience are keys to the success of turning around complex manufacturing situations.
- Management focus on training and promoting local managers is a key ingredient of a highly successful operation.

Mobilisation of co-financing. The Bank assisted to mobilise a further € 5,823 million of co-investment over the 1992 to October 2005 period, representing a multiplier of 3.08 times[2]. The total value of projects in which the Bank participated is € 8,626 million. The Bank is able to attract significant co-financings, particularly for infrastructure projects or in the frame of large syndicated transactions in more difficult sectors such as municipalities, general industries etc. The Bank's risk mitigation and co-ordination role was key in mobilising a significant amount of commercial co-financing for the majority of its investments in the last 2 years.

1.4. Portfolio Ratio

Based on the net cumulative business volume of € 2,803.4 million, the private/public portfolio ratio has improved since the last strategy from 64/36 to 65/35 (as of end October 2005). The current ratio reflects the focus on private sector investments and the large business volumes over the last two years. Also initial large public projects have started to repay. For the end of 2005, the ratio could temporarily reverse to 61/39 due to two important public projects which are expected to be signed. The potential for future sovereign operations is very limited because only on exceptional basis sovereign guarantees would be extended for projects in sectors where commercialisation goals are sought on the basis of transactions with a strong transition impact (e.g. transport, energy).

[2] Calculated as total project cost per net cumulative EBRD business volume

2. OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

2.1.1 Political environment.

2004 was an electoral year in Romania: following the Parliamentary elections of November 2004, the PD/PNL Alliance leader, Traian Basescu, won the second round of the presidential elections of December 2004 with 51% of the votes. President Basescu announced that Romania's accession to the EU and the fight against corruption were his main priorities.

Subsequently, the PNL (National Liberal Party) leader, Calin Popescu Tariceanu, was nominated as Prime Minister and formed a centrist, pro-business government. This raised hopes that Romania's remaining challenges in the EU accession process would be tackled in the course of 2005. The new coalition Government was approved by the Parliament by 265 votes to 200 in December 2004, and comprises four parties (PNL, PD, UDMR and PUR). The prospects for reform progress were strengthened by the fact that both the Government and the opposition parties are strongly committed to the 2007 date for accession to the EU.

Relations within the coalition are subject to a Governmental Coalition Protocol which provides the framework for legislative and governmental stability as it contains provisions related to the method of decision-making. However, the fragility and internal division within the four party ruling coalition have resulted in relatively little reform progress over the past year, and the Government was reshuffled on 22 August with a view to speeding up Romania's preparations for accession. As a result, preparations of the government's agenda have improved.

A European Commission Comprehensive Monitoring Report issued in October 2005 highlighted several areas where addition reforms are required prior to accession. These include important aspects of the rule of law, such as fighting corruption and fraud, increasing the transparency of public procurement, and tightening border controls. President Basescu and the Government remain committed to addressing the remaining reform challenges and to meeting the January 2007 date for accession. The European Commission will issue an updated monitoring report in Spring 2006 which will determine whether Romania accedes in 2007 or 2008.

2.1.2 EU accession and regional integration

Romania's goal is to join the EU by January 2007, a target endorsed by the EU summit meeting in December 2004. Romania completed EU accession negotiations by the end of 2004 and signed an accession treaty in April 2005. The accession treaty contains three 'safeguard clauses' on economics, the internal market, and justice and home affairs which could be invoked by the European Commission in case of serious shortcomings. The EU has indicated that Romania's membership could be delayed if it does not speed up public administration reform, effective implementation of the reform of the justice system, and effective enforcement of the fight against corruption. In addition, the accession treaty stipulates that the European Commission could at any time before that treaty comes into force suggest to the European Council to postpone the date of accession by up to one year i.e. until January 2008 if there is evidence that the country will be unprepared for membership requirement by 1 January 2007.

On 25 October 2005 the European Commission issued its latest Comprehensive Monitoring Report urging Romania to accelerate its efforts and tackle the sensitive areas where the reforms have advanced at a slower pace recently. In the Report, key areas were outlined where Romania has to intensify its effort to avoid seeing its accession delayed by one year to 2008. The areas include: improving the border control; fight against corruption and fraud; improving the veterinary control in the farming sector; setting up the agency for direct payments in the farming sector; strengthening the control over the utilisation of regional development funds; improving environmental control (curbing industrial pollution); improving public procurement procedures; setting up the IT system needed by VAT collection. The most critical of the above are: (1) border control; (2) fight against corruption;

(3) environment; and (4) management of EU funds. A final decision on whether Romania meets the requirements for joining the Union in January 2007 will be taken by the European Council in April or May 2006 when a new report will be drafted.

2.1.3 Socio-Economic Environment

Population: At the latest census, held in March 2002, the Romanian population was estimated at 21,698,181, a decline of 4.9 per cent since 1992. The decline has been a result of a combination of declining birth rates, increasing mortality rates and emigration. The birth rate declined from 13.6 per 1,000 inhabitants to 9.8 per 1,000 in 2003. The overall death-rate increased from 10.6 per 1,000 inhabitants in 1990 to 12.3 per 1,000 in 2003. Emigration has been a major cause of population decline. Estimates of Romanians working abroad range between 900,000 and 1.8 million (between 5 and 10 per cent of the adult population). Some 12 per cent of Romanian household have at least one member working abroad, which explains the large inflows of remittances. At the beginning of 2004, the rural population of Romania was 10,068,000, representing 46.4 per cent of the total population[3], which constitutes one of the highest levels in Europe. Nearly 60 per cent of the population aged 60 years and above live in rural areas and in rural areas the elderly represent over 24 per cent.

Minority Groups: According to the 2002 census, 19 million citizens (89.5 per cent of the total population) declared themselves as ethnic Romanians. Ethnic Hungarians fell from 7.1 per cent of the population in 1992 to 6.6 per cent in 2002. However, at 1.4 million they remain the largest minority group. According to the 2002 census, the Roma numbered 535,250 (2.5 per cent of the population) compared with 1.8 per cent in 1992. However, estimates from different sources put the number of Roma at 2 million. According to the Government, only 27 percent of Roma had steady jobs and only half of those jobs were considered skilled. Illiteracy among Roma older than 45 years of age was approximately 30 percent.

Romania is a party to the European Social Charter and the Framework Convention for the Protection of National Minorities (since 1995). There were 50 members of minorities in the 469-seat Parliament. The Constitution and law grant to each recognised ethnic minority one representative in the Chamber of Deputies if the minority's political organization cannot obtain 5 percent of the votes needed to elect a deputy outright. Organisations representing 18 minority groups qualified for deputies under this provision in November. Ethnic Hungarians, represented by the UDMR, obtained parliamentary representation through the normal electoral process. Roma were underrepresented in Parliament, having only one representative.

Education: The level of educational attainment in Romania is similar to that in other countries of the region. The main enrolment problem is in secondary education. In 1990/91 the gross enrolment rate was 91 per cent of relevant age group, dropping to 84 per cent in 2002/2003[4].

Health: The average life expectancy in Romania was 70.9 years in 2003, virtually unchanged since the beginning of transition. This is low by the standards of the region. Over the past three decades life expectancy for males in Romania has remained at roughly the same level. Infant mortality has declined from 26.9 deaths per 1,000 live births in 1989, to 17.3 deaths per 1,000 live births in 2003, but even so it is more than double that in Poland, Hungary and Slovakia The maternal mortality rate fell from 83.6 per 100,000 live births in 1990 to 41.8 per 100,000 in 1999, reflecting the liberalisation of abortion. However, it remains at a level six times that of Poland and Hungary. The main causes of death are similar to those in industrialised societies, but tuberculosis remains common. Romania has a healthcare system that is almost entirely owned by the state and is funded by a combination of employer and employee contributions to the National Healthcare Insurance Fund and direct allocation from the state budget. Romania was one of the last of EU candidate countries to introduce an insurance-based health system in 1998.

[3] UNDP, Romania: National Human Development Report 2003-4
[4] World Bank (2005), World Development Indicators – 2005.

Human Development and Poverty: Romania ranks 69th in the world in terms of human development[5]. The World Bank estimates that in 1994 21.5 per cent of the population lived below the national poverty line, and that in 2002 14 per cent of the population lived below US$ 2 per day[6]. There is a concentration of severe rural poverty in the Moldavian counties.

Civil Society: Citizen participation at the local level in Romania is still limited. Nearly 50 per cent of Romanians are not satisfied with the services offered by their local governments[7].

Human Rights: Romania continues to respect human rights and fundamental freedoms and has made further progress in several areas. Romania has ratified the main human rights conventions, but has still to ratify Protocol 12 to the Convention for the Protection of Human Rights and Fundamental Freedoms prohibiting discrimination on any grounds. The National Council for Combating Discrimination (NCCD) has continued its policy to prevent discriminatory actions. The highest number of complaints received by NCCD between 2003 and 2004 related to discrimination based on ethnicity followed by retirement rights.

Homosexuality was decriminalized in 2001, but some NGOs report that there is still a high degree of hostility against homosexuals, including violence by police[8].

Equal Opportunities and Gender: While the law allows women's participation in government or politics, societal attitudes are a significant barrier to entry, according to the US State Department[9]. In the new Parliament, 38 of 332 deputies and 13 of 137 senators are women. There are three women in the new 25-member Cabinet.

The law prohibits any act of gender discrimination, including sexual harassment, but few resources are available for women to deal with economic discrimination.

2.1.4 Labour Issues

The Romanian trade unions have been the most militant in the whole transition region, with strikes having affected every sector of the economy. A series of strikes prompting quick concessions by weak governments, in turn encouraging further worker militancy have contributed significantly to the fragility of Romania’s transition. Labour unrest has declined in recent years.

The estimates of the number of children considered to be "economically active" vary (0 according to the World Bank Development Indicators, and between 83,000 and 142,000 of the population between the ages of 5 and 17 according to the ILO and the National Institute of Statistics of Romania)[10]. With ILO support, the Government began in 2004 to implement a comprehensive programme to eliminate child labour that included measures to prevent the increase of child labour in both urban and rural areas and build the capacity of government and NGOs to address child labour cases. Transposition of the acquis on social policy and employment has continued, but some legal adjustments are still needed. New legislation on children’s rights and adoption entered into force in January 2005, bringing Romania in line with the UN Convention for the Rights of the Child and the European Convention on Human Rights and completes the reform of child protection. The Constitution prohibits forced or compulsory labour, including child labour.

Efforts are now needed to focus on completing legislative alignment in the area of labour law and on strengthening the Labour Inspectorate to ensure proper implementation in the area of health and safety at work.

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[5] UNDP: 2004, Global Human Development Report.
[6] World Bank (2005), World Development Indicators – 2005
[7] Ibidem
[8] US State Department (2005), Country Report on Human Rights Practices - Romania, 2004
[9] Ibidem
[10] All estimates refer to 2003.

2.1.5 Integrity issues

Romania occupied the 85th place in Transparency International's Corruption Perceptions Index for 2005, behind all EU members and other candidate countries. On its 10-1 score measuring integrity (10 = clean) it rose slightly from 2.9 in 2004 to 3.00 in 2005. An Office for the Prevention and Control of corruption is functioning and investigations and enforcement of legislation have started. But only limited progress has been made towards combating high-level corruption under the Social-Democrat-led coalition of Prime Minister Adrian Nastase, which left office after the November-December 2004 elections. In 2003, parliament passed legislation that, in effect, softened anti-corruption laws affecting high officials and public servants. Until the November-December 2004 elections, there have been no convictions of high officials despite the media focus on a series of corruption cases involving members of the ruling Social Democratic Party. The issue of high-level corruption figured prominently in the winter 2004 election campaign. The new centre-right coalition government of Prime Minister Calin Popescu Tariceanu has promised a crackdown on corruption as a top priority. The political sensitivity of the judicial reform issue in the context of the fight against corruption was vividly illustrated by an episode in the summer of 2005. A complex legislative package designed to complete reform of property rights and the judiciary went through parliament in June 2005, but the Constitutional Court rejected four articles of this package on the basis that they were unconstitutional, on 6 July. The government claimed the rejection as further evidence of corruption in the judiciary and an attempt to preserve the status quo and threatened to go for early elections in order to seek a stronger mandate from the electorate. The resignation threat was withdrawn, with both the government and the President committing fully to appropriate action in this sector. The articles rejected were then revised and the whole package was promulgated in mid-July.

The incidence of crime against persons and property in Romania is low by international standards and has been falling in recent years, according to the Economist Intelligence Unit (EIU). In contrast to other countries in South-Eastern Europe, Romania benefits from the absence of organised crime. However, cyber crime is a growing problem for businesses, especially Internet credit card fraud by sophisticated local hackers. Money-laundering is also a problem. The European Commission's 2005 Comprehensive Monitoring Report on Romania notes - regarding the fight against money-laundering - that alignment with the Second Money Laundering Directive was completed through the adoption in September 2005 of the amendments to the Law on preventing and sanctioning money laundering. The Report also states that, in order to ensure the full implementation in practice, further efforts are now needed to improve the institutional framework as well as the operational capacity of law enforcement agencies fighting crime linked to money laundering. It specifies that further training is needed for magistrates and a more proactive attitude by investigative and prosecutional bodies would assist in fighting money laundering effectively.

The law prohibits trafficking, which continues to be a serious problem according to the 2004 Report on Human Rights Practices in Romania published by the US State Department Bureau of Democracy, Human Rights and Labour in February 2005. The government continues to fight against trafficking in human beings via the National Office for Trafficking Prevention and Victim Monitoring, established in September 2004. The law defines trafficking as the use of coercion to recruit, transport, harbour, or receive humans for exploitation.

2.1.6 Legal reform

In recent years Romania has made considerable progress in reforms mainly motivated and driven by Romania's need to harmonise its body of laws with that of the EU for early accession. Reforms in respect of mortgage market laws are at an advance stage but have yet to pass the final stage of approval (draft Law on the amendment and supplementation of Law No. 190/1999 on the mortgage loan for real estate investments, the draft Law for supplementing Law No. 7/1996 on the cadastre and real estate publicity, the draft Law on the mortgage loan banks, the draft Law on mortgage bonds and the draft Law on the conversion of receivables into shares were sent to the Senate in September 2005). The adoption of this package of laws will allow the establishment of mortgage loan banks and the refunding of the lending system for houses by way of bond issues guaranteed with mortgages on the houses to be built contributing to improving the real property market and the financing thereof.

Further to earlier reforms in the area of moveable security law, early (but preliminary feedback) indicates a relatively effective enforcement of the rights of secured creditors although some uncertainty remains in the context of bankrupted estates. Notwithstanding the governments renewed effort to tackle the issue, corruption remains an issue in the government bureaucracy and civil service. The ability of citizens to start businesses is encumbered by red tape. Courts still cannot be relied upon to enforce contracts or resolve cases impartially, due in large part to an under-trained, low-paid, and inexperienced judiciary that is often susceptible to corruption.

2.1.7 Environment

Romania continues to face severe environmental problems concerning air, water and soil pollution, which require large investments and the participation of both public and private sector. Serious air pollution from power stations and other industrial plants, especially heavy metals, motor vehicles, and domestic heating need to be further addressed. Significant improvements are still needed in the fields of waste management, improving access to the sewage treatment plants, improving drinking water quality, reducing underground water pollution, enforcing integrated pollution prevention and control.

To help address the legacy of environmental damage and encourage environmental quality improvements, the Bank incorporates environmental action plans into most projects.

A background section on environmental issues in Romania and examples of recent projects is found in Annex 3.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for Bank operations

In the first half of 2005, the economy grew by an estimated 4.9 per cent year-on-year, after record GDP growth of 8.3 per cent in 2004 and 5.2 per cent in 2003. On the demand side, growth is increasingly led by private consumption, which in 2004 rose by 10.1 per cent and in the first half of 2005 by 11.7 per cent, fuelled by rapid credit expansion and the enforcement of a flat income and profit tax rate of 16 per cent as of January 2005. Gross fixed capital formation, the second most important driver of growth, rose by 10.1 per cent in 2004 and 7.6 per cent in the first half of 2005. The investment ratio remains high at 22.5% relatively to that of both old and new EU members. The strong agricultural performance of 2004 is unlikely to be repeated in 2005 because of flood damages.

Because of loose fiscal, incomes and monetary policies, disinflation has been slower than it normally would be expected, in particular in 2005, especially given the 15 per cent real appreciation of the currency in the first nine months of 2005. Annual inflation fell from 14.1 in December 2003 to 9.3 in 2004 and 8.7 in March 2005, but picked up again temporarily in April to July due to increases in excise taxes and administered prices and fell again to 8.5 per cent in September 2005. In August 2005, the monetary authorities moved from an exchange rate-based monetary framework to a formal inflation targeting regime. The target for 2005 is 7.5 per cent and for 2006 5 per cent with a +/-1 per cent margin on the assumption that there would be no change to the VAT rate. It is now very unlikely that 2005 inflation will be less than 8.5 per cent in 2005. The central bank is now deeming its own forecast of 6.5 per cent for 2006 as unrealistic.

The gradual liberalisation of the capital account began in April 2005 and is due to be completed in September 2006. To prevent speculative short-term capital inflows and possible currency[11]

[11] On 1 July 2005, the RON became the new official currency of Romania. The redenomination implies the exchange of 10,000 ROL for 1 RON. The two sets of notes will co-exist for 18 months.

appreciation, the National Bank of Romania (NBR) has cut the policy interest rate by a cumulative 1375 basis points between June 2004 and November 2005, reducing the interest rate differential with the Eurozone. However, despite the lowering of the interest rates, the still relatively high return on RON assets attracted speculative capital inflows during August 2005 (since April 2005 the balance of payments recorded € 8 billion portfolio inflows, only € 3 billion of which estimated to be remittances). This resulted in an appreciation of the currency which the central bank tried to neutralise through heavy intervention in the forex market. This sent mixed signals to the market following the announcement in October 2004 that it would pursue a more flexible exchange rate, and the introduction of inflation targeting in August 2005. The heavy interventions in the forex market also caused the central bank losses estimated at 1 per cent of GDP in the first nine months of 2005. The central bank has now negative net worth and will need at some point to be recapitalised. Further cuts in the central banks reference rate and intervention rates resulted in negative real central bank interest rates.

The liberalisation of the capital account imposes limitations to the central bank toolkit to reach its inflation target. It is therefore likely that in order to reach the inflation target and to curb speculative capital inflows, the central bank will make increasing use of other tools such as minimum reserve requirements and tighter prudential standards for commercial banks.

Incomes policy has been lax. In a pre-electoral move the former government implemented two wage increases for the budgetary sector in October and November 2004. In January and October 2005 the current government also increased these wages by 8.1 and 9.2 per cent respectively. As a result, in the past year wages in the budgetary sector have increased by a cumulative 49 per cent. The government is now planning a further wage increase in January 2005 by 5.5 per cent and the re-introduction of bonuses.

During negotiations to complete the second and third reviews under the precautionary Stand-By Arrangement (SBA) with the IMF, an agreement was initially reached on a new 2005 budget deficit target of 0.7 per cent of GDP. The government subsequently increased the target to 1 per cent of GDP to reflect expected increased expenditure to deal with the costs of damages from widespread repeated flooding in summer 2005 and decided to increase public sector wages. In order to offset the large loss of tax revenues related to the introduction of a flat personal and corporate income tax (the rate is now set at 16 per cent), the government announced that it will focus its efforts on improving tax collection from the enterprise sector. As a result of constrained spending on materials and infrastructure, and increased VAT revenues linked to the consumption boom, in September 2005 the budget recorded a nine-month surplus of 0.7 per cent of GDP. The endeavour of the government to inject close to 2 per cent of GDP in public expenditure into the economy in the last months of the year, as showed by the end of November budgetary rectification of the 2005 budget, confirms the unbalanced fiscal policy stance. The government's budget deficit target for 2006 has been set at 0.5% of GDP. The fiscal targets for 2005-6 were deemed unsuitable by the IMF. This, together with the loose monetary and incomes policies, the unwillingness to bring domestic gas prices in line with world prices and some sluggishness on structural reforms, caused the IMF to declare the SBA programme off-track in October 2005.

The twelve-months trade deficit increased by almost 50 per cent in August 2005 with respect to August 2004. The first eight months of 2005 trade deficit totalling € 4.5 billion, contributed to a current account deficit of € 3.2 billion, up from € 1.7 billion in December 2004 (7.6 per cent of GDP). Due to the rapid exchange rate appreciation and the cost-push effects from wages and energy prices, import growth, at 36 per cent year-on-year, outpaced export growth of 33 per cent in September 2005. Imports of consumer goods (cars and processed food and beverages) recorded high growth rates on the back of wage increases, lower taxation and a credit boom. FDI (excluding capital transfers) covered just over 93 per cent of the current account deficit in 2004. However, the IMF predicts FDI coverage of the current account will drop to 60 per cent in 2005 (in August 2005 it accounted for 77 per cent) and to 40 per cent in 2006, in the best case scenario. International reserves reached record level of 6.2 months of expected annual imports of good and services in September

2005, following significant central bank interventions in the forex market during 2005 to prevent the exchange rate from appreciating.

Economic growth has been strong but is likely to moderate in the run-up to EU membership. Its drivers have shifted from investment towards private consumption, which is fuelling an import boom. Reducing direct taxation, liberalising the capital account and introducing a formal inflation targeting regime pose new monetary and fiscal challenges. Currently these challenges are not being met by an appropriate set of economic policies. This is resulting in widening domestic and external deficits, a state sector starved of funds for major social sector reforms and investments in infrastructure, and has already produced a partial loss of the competitiveness gains achieved in 2003-2004. Unit labour costs have decreased by approximately 25 per cent in the first nine months of 2005[12].

To improve competitiveness and attract higher FDI necessary to cover an increasing current account deficit the authorities will need to tighten their set of economic policies and make them coherent and credible, and at the same time pursue the continuation of structural reforms. In particular, high on the agenda are the reform the labour market, in particular by lowering social contributions, which remain high compared to neighbouring countries, and by eliminating rigidities linked to the mandatory features of collective contracts; the alignment of domestic gas prices with international gas prices (the gap between domestic and world prices which was supposed to be narrowed to 40 per cent by the end of 2005 has now reached 70 per cent); and, last but not least, the acceleration of the implementation of the fight against corruption.

2.2.2. Transition success and transition challenges

Stimulated by the goal of EU accession, Romania has made significant progress with structural reforms. By the end of 2004 EU accession negotiations were completed and all chapters of the *acquis communautaire* were provisionally closed. In its 2005 Regular Report the Commission concluded that Romania continues to comply with the criterion of being a functioning market economy. However, headway with the implementation of the structural reform programme is needed in order to enable Romania to cope with competitive pressures in the single market.

Aside from the formal recognition achieved by the completion of EU negotiations, progress towards reaching the standards of a market economy has been recognised also by the Bank in its annual exercise of monitoring structural reforms developments in its countries of operation. Table 2, illustrates the progress made by Romania with structural reforms in relation to progress made by the countries which have become EU members in 2004 and by Bulgaria, also scheduled, like Romania, to become a EU member in 2007. The most significant improvements have been recorded through the EBRD Transition Indicators in the areas of privatisation (2004), banking reform (2004) and governance and enterprise restructuring (2005).

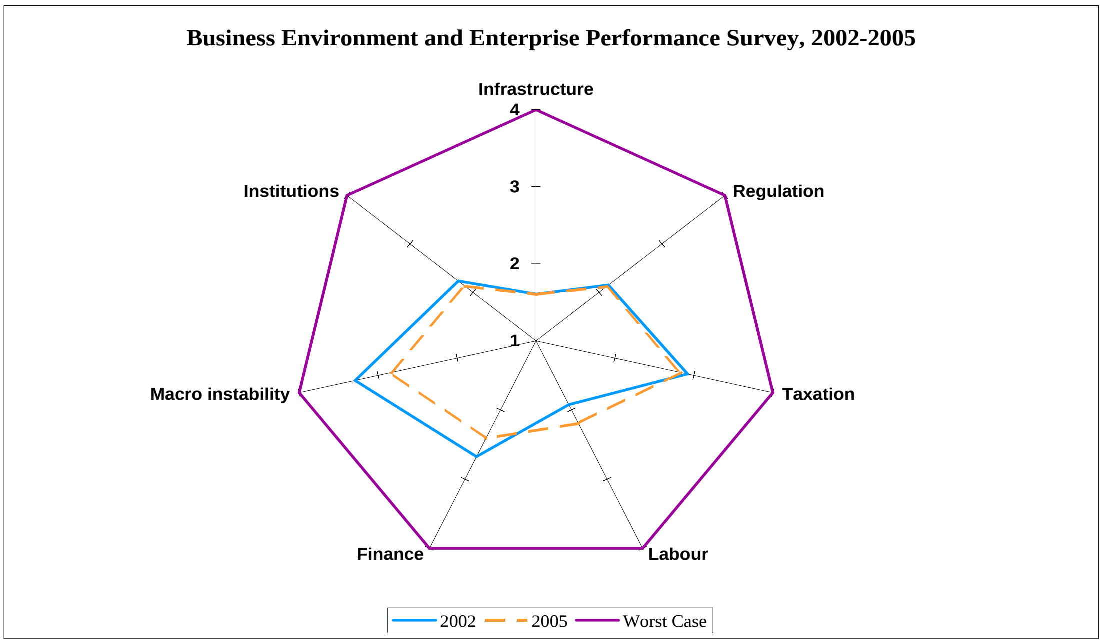
[12] The deterioration of labour productivity may be less strong than indicated by official statistics. Surveys have revealed that reports filed by employers may have under-estimated the shedding of labour in some sectors with declining activity due to the formalisation of labour contracts after the introduction of the flat rate. Moreover, the high employment growth in some other sectors may be due to the change of status from informal to formal employee. Both effects would statistically lower labour productivity, although not so in the real economy.

Table 2: Transition Indicators[13] of EU accession countries, 2005 (in alphabetical order):

	Large scale privatisation	Small scale privatisation	Enterprise restructuring	Price liberalisation	Trade & Forex system	Competition Policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Overall infrastructure reform
BULGARIA	4.00	3.67	2.67	4.33	4.33	2.67	3.67	2.33	3.00
CZECH REPUBLIC	4.00	4.33	3.33	4.33	4.33	3.00	4.00	3.67	3.33
ESTONIA	4.00	4.33	3.67	4.33	4.33	2.67	4.00	3.33	3.33
HUNGARY	4.00	4.33	3.67	4.33	4.33	3.00	4.00	4.00	3.67
LATVIA	3.67	4.33	3.00	4.33	4.33	2.67	3.67	3.00	3.00
LITHUANIA	4.00	4.33	3.00	4.33	4.33	3.00	3.67	3.00	2.67
POLAND	3.33	4.33	3.67	4.33	4.33	3.00	3.67	3.67	3.33
ROMANIA	3.67	3.67	2.33	4.33	4.33	2.33	3.00	2.00	3.33
SLOVAK REPUBLIC	4.00	4.33	3.67	4.33	4.33	3.00	3.67	2.67	3.00
SLOVENIA	3.00	4.33	3.00	4.00	4.33	2.67	3.33	2.67	3.00
Accession Countries	**3.77**	**4.20**	**3.20**	**4.30**	**4.33**	**2.80**	**3.67**	**3.03**	**3.17**

Due to the many positive steps taken by the government to improve the business environment and its efforts in listening to the concerns of investors, businesses noticed improvements in several areas. As perceived by the entrepreneurs interviewed in the EBRD/World Bank run Business Environment and Enterprise Performance Survey in 2005, business environment in Romania has improved since the last strategy. The largest improvements are recorded in the cost of doing business[14], macroeconomic stability, and access to finance[15]. In some areas progress is yet to be perceived, while in two areas, labour market and taxation[16], conditions have worsened to a small extent. Chart 1 contains a summary of the weight assigned by the entrepreneurs interviewed in 2002 and 2005 to various areas of the business environment. Scores range from 4 = serious obstacle to 0 = no obstacle.

Chart 1 Entrepreneurs' perception of the business environment.



[13] The index ranges from 1, indicating little or no progress, to 4+ pointing to standards similar to advanced economies.

Source: EBRD Transition Report 2005.

[14] Source: EBRD Transition Report 2005.

[15] The only statistically significant changes in the perception of the business environment in Romania are the following: macroeconomic instability (improvement), labour market (deterioration) and taxation (deterioration).

[16] As the BEEPS was run in Romania during early spring 2005, it is possible that the expected positive impact of the January 2005 introduction of a 16% flat corporate tax rate was not yet perceived by the respondents. Within the broad area of taxation, entrepreneurs identified tax administration as the aspect that represented a more binding constraint to doing business.

Table 3 summarises the recent EBRD analysis of the remaining sectoral challenges on three different levels: structure, institutions and conduct of markets. According to this analysis, in Romania the Bank can help address through its investment projects important transition challenges in every sector.

Table 3. Status of remaining transition challenges on a sectoral basis, 2005 (in alphabetical order)

ROMANIA	Structure	Institutions	Conduct
Agribusiness	*Medium*	*Medium*	*Medium*
Banking	*Medium*	*Small*	*Medium*
Energy Efficiency	*Medium*	*Medium*	*Medium*
General Industry	*Small*	*Medium*	*Medium*
MEI	*Medium*	*Medium*	*Medium*
MSMEs	*Medium*	*Medium*	*Medium*
Natural Resources	*Medium*	*Medium*	*Medium*
NBFIs	*Small*	*Medium*	*Medium*
Power	*Medium*	*Small*	*Medium*
Private Equity Funds	*Medium*	*Large*	*Medium*
Property and Tourism	*Large*	*Medium*	*Medium*
Telecommunications	*Small*	*Medium*	*Medium*
Transport	*Medium*	*Medium*	*Medium*

The main gaps are in infrastructure, natural resources, agribusiness, property and tourism and in SME

Because there is still a clear need for the Bank to support improvements in all sectors, the strategy of the Bank will remain broad based in its investment activity, to ensure a balanced approach to sectoral development. In order therefore to pursue this goal and help Romania continue on its advancement of the transition process, the Bank's activities will address the following challenges (in alphabetical order):

Agribusiness: The government still supports the sector through subsidies, import tariffs and occasional licensing and quantitative restrictions on exports. Land reform has been completed. Significant foreign investment in agricultural land is taking place although in most cases the acquired land is not cultivated, which might indicate that the investment is linked to prospects of future receipt of EU subsidies. There are still a large number of non-viable state farms. The process of privatising agro-processors, input suppliers, storage and services companies has been slow. An appropriate financial system for agriculture is developing, but the different types of collateral services need further development (including the ability to use land as collateral, establishing a better functioning warehouse receipts system, developing grain grading and commodity systems).

Banking: Competition has started to have an impact on interest rates. However, market concentration is still high. The three largest banks dominate the sector, which is generally well-capitalised. The state still holds 33 per cent of total banking assets, concentrated in Banca Comerciala Romana, the Saving Bank (currently in the process of privatisation) and Exim Bank. Consumer and mortgage credit are expanding rapidly, but they are at very low level (for instance, 2% of GDP in the case of mortgage lending, as compared to an average of 35 per cent in the EU). Market-based conduct and accounting and transparency standards are fairly well developed. Financial intermediation is very low at 15 per cent of GDP, and domestic credit to the private sector, although fast increasing is even lower at 10 per cent of GDP.

Energy Efficiency: Romania has adopted an energy efficiency law and ratified the Kyoto protocol. However, the market for energy efficiency and conservation is still at an early stage of development, with only a few ESCOs active on the market. Demand side improvements are introduced in an *ad hoc* manner. Several JI projects are currently implemented. The Kyoto protocol and EU accession are likely to accelerate the implementation of energy efficiency incentives, standards and institutions.

General Industry: The legal and regulatory framework has been strengthened (including the tax code, competition legislation and bankruptcy legislation) and enterprise restructuring has progressed as a result of privatisation of large state owned companies and a substantial increase in foreign direct investment. However, significant improvements in the efficiency, transparency and accountability of the public administration and the judiciary are still needed. Enterprise subsidies are close to 15 per cent of GDP. Standards of corporate governance and business conduct require significant improvements.

Municipal and Environmental Infrastructure: While in larger cities local infrastructure services are generally provided through commercial enterprises, these services are still generally provided by local or regional government departments at the county level and in small and medium sized municipalities. Private sector participation, mostly in the form of concessions in the water and heating sectors, is emerging, but remains sporadic and difficult to implement. An autonomous national regulator for municipal services has been established and tariff reform is being implemented, but there remain considerable challenges for the coordination of service monitoring, regulation and pricing between the local, county and national levels.

MSMEs: According to the World Bank, starting a business carries small to medium costs: it takes 5 different procedures, an average of 11 days and 5.3 per cent of GNI per capita to register a company. A national network of one-stop-shops is in place to co-ordinate the process of business registration and certification with all relevant organisations. While institutional changes were enacted recently to simplify tax administration, they actually resulted in more lengthy procedures for tax compliance for MSMEs. A private credit information bureau is in place providing information on only 1 per cent of the population. Collateral and bankruptcy legislation are moderately supportive of MSME lending. Local banks and leasing companies extend loans/leases to MSMEs, often under IFI-supported credit lines. A microfinance bank has been active since 2001 and together with Non-Bank Microfinance Institutions (NBMFIs) targets the smallest enterprises.

Natural Resources: Substantial progress took place in this sector with the privatisation of Petrom, the integrated state-owned oil and gas company, to Austria's OMV. This successful privatisation was conducted according to the schedule agreed by both the Bank and the World Bank. The privatisation, to which the Bank contributed significantly, is seen by both the authorities and the investor community as a good example of a transparent and market-based conduct, as it was carried out according to best international practice, and as an example for future privatisations. Tariff reform has progressed well, though some remaining challenges in enforcement of payments discipline at the gas distribution level and market level pricing persist. Domestic gas prices have not yet been aligned with world prices, on the contrary the gap between domestic and world prices is increasing. The independence of the regulator in this sector needs to be strengthened. Environmental legacies remain. The private sector involvement in Romgaz would improve the ability to develop and export gas. Commercial restructuring of Transgaz and Conpet should streamline costs and third party access.

Non-bank financial institutions: Securities markets legislation and regulation almost meet IOSCO standards but in several important areas, implementation of the regulation is poor, reducing the scope of the effectiveness of the regulator. Insurance legislation and regulation almost meet IAIS standards but the regulator needs further strengthening. Recently introduced occupational pensions legislation is flawed and requires revisions with respect to minimum return requirements and restrictive investment guidelines. Capital markets have grown gradually over the years but they are small relative to most of the EU member states in the CEB. Insurance penetration is low. Leasing has become a popular financing instrument.

Power: Significant reforms have been implemented in the power sector, which now enjoys a well developed regulatory framework. An independent regulatory authority has been established and has embarked on the implementation of tariff reforms and Third Party Access to transmission and distribution grids. Tariffs are relatively high and their structure is balanced. An independent transmission operator exists. Introduction of private investors to the sector has been slow but has been gaining momentum. The country is also a signatory to the Treaty establishing the Energy

Community of South East Europe, emphasising its intention to meet the reform and restructuring requirements that will align it with the other signatories to create an open regional market in Southeast Europe and ultimately meet the requirements remaining before it is compliant with the EU Energy Directives. In that regard, the country is also at the vanguard of trading expertise in the region, having established a trading exchange to facilitate electricity trading, initially domestically, but eventually also regionally. Nevertheless, the sector is characterised by a large quasi-fiscal deficit. Key challenges facing the Government are: strengthening the independence of the regulator, improving utilities' collection rates, increasing the efficiency (including environmental upgrade) of the network, and successfully completing the privatisation process, especially in the natural gas sector. Some preliminary steps in this direction have been taken. In July 2004 the government finalised the sale of a 51 per cent stake in Electrica Banat and Electrica Dobrogea to Enel of Italy for a total of € 112 million. German utility E.ON was the sole bidder for Electrica Moldova, which sold for € 100 million, while CEZ of the Czech Republic was selected to take over 51 per cent of Electrica Oltenia for a total of € 151 million. The remaining four electricity distribution companies are due for privatisation in 2006. The privatisation of co-generation and thermal generation companies has been recently initiated. However, the privatisation process for the three main thermal generation complexes is on hold for the time being.

Private Equity Funds: The private equity fund sector remains small and falls behind that of the new EU member states. Most of the funds raised by private equity funds have come from abroad, with private individuals contributing more than half of the funds, followed by corporate investors and government agencies. Increased business activity by equity funds, including offering a broader range of financial instruments, is needed to improve the visibility of the sector and its role in supplying finance to local enterprises.

Property and Tourism: The property sector in general and the Bucharest office market in particular has developed rapidly over the last two years as both private local and international developers, and institutional investors look to the country with its significant levels of foreign direct investment and ahead of EU membership. Similarly, the retail sector has seen significant levels of investment in new and prospective facilities fuelled by growing consumer consumption. Large imbalances, however, exist between the capital and the regional cities in terms of investment in the office, hotel, retail and residential markets although there are recent signs that developers are beginning to widen their interests to include the major secondary cities. The restructuring and investment in the tourism sector is still in its early stages being sympathetic of the nature of Romanian tourism which is unlikely to involve mass-market activities attracting significant levels of investment from major international tourism companies but rather smaller cultural and eco-tourism models requiring lower levels of investment.

Telecoms: The privatised telecom operator continues to have a dominant position in most segments of the voice sector but is constantly losing market share to alternative operators. There is an active independent regulator, which follows closely the applicable EU Directives, with a positive result in increasing competition and rebalancing tariffs. Provision of innovative services (e.g. Internet) lags behind but is being addressed as a priority by most of the operators.

Transport: In the railways sector operating and policy setting functions have been separated and core railway businesses (infrastructure, passenger, freight, etc.) have been unbundled while ancillary services have been divested. Infrastructure access is granted on a non-discriminatory basis, but the regulator is still the Ministry of Transport. Private sector is involved in railway related activities and also in growing numbers of private freight and passenger operators.

The road sector policy statement was approved by the government in June 2002 and NAR was legally transferred from "regie autonoma" to a joint stock company in 2004. The first corporate plan was subsequently approved in 2004. There is a law on PPP but no PPP projects have materialised so far. Periodic maintenance of public roads is contracted out to the private sector.

2.3. Access to Capital

Romania's level of indebtedness is low and has so far been decreasing. Total external debt is low at € 26 billion (June 2005), less than 8 per cent of which is short term. Medium and long term external debt is roughly equally balanced between private and public (including publicly guaranteed) debt. It is likely that with the full opening of the capital account in 2006 and with the increased need to co-finance through PPPs the infrastructure and environmental investments required by EU accession, the trend of decreasing external indebtedness will be reversed.

The government is in the process of preparing a strategy for the management of its external debt, which will involve a continuation of the current trend towards increased bond maturity (12-15 years), increased market liquidity and improved transparency, a shift towards a more balanced currency composition of the debt through increased issuance of Leu denominated bonds, and the creation of a separate agency for the management of public debt.

In September 2005, on the back of improvements in the general government fiscal indicators and the prospects of European Union membership, Standard & Poor upgraded Romania's foreign currency rating to the investment grade level, BBB-, with a stable outlook. This follows Fitch's upgrade of Romania's foreign currency rating by two notches from BB to BBB- in November 2004, and was itself followed by a similar upgrade by the Japan Credit Rating Agency. Moody is the only rating agency which has Romania at sub-investment level, Ba1 with positive outlook.

Convergence of spreads with Bunds[17] is taking place with Romania 2010 and 2012 below 57 basis points vs. Bunds in September 2005.

Access to foreign currency loans for Romanian companies is likely to be constrained by the high and possibly increasing reserve requirements imposed on the commercial banks borrowing in hard currency.

There are two active stock exchanges, the Bucharest Stock Exchange (capitalisation € 13.7 billion in November 2005) and the Rasdaq Stock Exchange (capitalisation € 2.2 billion in November 2005). In addition there is also the Sibiu Monetary Financial and Commodities Exchange, dealing with futures, options and derivatives. Their turnover is gradually improving albeit from a very low base (the larger of the three exchanges registered turnover of € 1.7 billion in 2005, up from € 600 million in 2004). Plans to merge them have so far failed, but a possible boost to their role will follow the government's plan to list 10 per cent of all its remaining state assets on the local stock exchanges.

[17] Bundesanleihen, the German government's federal bond.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

The Bank's investments over the forthcoming strategy period will address the transition challenges previously outlined, and they are in line with the Romanian National Development Plan for the medium term, in particular in the areas of improving competitiveness of the enterprise sector, transport and environmental infrastructure and the agribusiness sector. A particular focus will be on the following objectives:

- Continue to support the infrastructure development particularly through the transfer to private ownership and commercialisation of energy utilities. Support the government's efforts to utilise PPP financial structures to address the investment needs in the infrastructure sector. Prioritise infrastructure development designed to address regional integration. Previous experience has shown that existing PPP legislation should be improved to encourage large investments based on PPP concept. The Bank is leading a working group, established by the Government with the participation of EU, WB, IMF and EIB, whose aim is to allow the Government to select the proper structure and tendering process for a public-private partnership. As a model PPP the Government has proposed to start with projects in the road sector to be tendered out and negotiated during the second half of 2006. Such model PPP concept should then be extended into other sectors.
- Continue to support the private sector together with foreign and local investors with a special focus on equity. Further support the improvement of the investment climate through ongoing policy dialogue.
- Contribute to the broadening and deepening of financial intermediation through strengthening financial intermediaries and facilitating the availability of a wide range of financial products. Supporting the development of the local capital markets and access to local currency funding is a key priority.

In achieving its objectives the Bank will also contribute to strengthen the administrative capacity of the Romanian public administration and local authorities to absorb both the pre- and post accession funding in close co-operation with the EU and the EIB under JASPERS (Joint Assistance for Preparing Projects in European Regions).

The Bank’s early project pipeline in power, energy efficiency, general industry (especially forestry), agribusiness (especially food products) and municipal and environmental infrastructure is encouraging.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Energy and Infrastructure

3.2.1.1 Power, Energy Efficiency and Natural Resources:

The Bank has signed 12 loans in the power, energy efficiency and natural resources sectors committing about €359 million for total project costs of €943 million. Four projects are in the private sector and 8 in the public sector out of which 4 are non-sovereign projects. Two projects are equity participations. The Bank mobilised commercial co-financing for 3 of these projects and IFIs parallel co-financing and EU grant funding for other 4 projects.

The Bank will be active in its policy dialogue with stakeholders (regulatory bodies, government institutions, and energy companies) in order to ensure that regulated sector segments (in particular electricity and gas distribution, and electricity transmission) receive tariffs in accordance with a transparent and formula-based tariff methodology, independent of political interference. Priorities will be to provide support for the key transition challenges relating to the following:

- A critical area for Bank support will be the financially vulnerable but strategically important thermal generation plants. The Bank will seek to support their prior rehabilitation and partner with strategic investors to complete successful privatisations. Specifically, the Bank will focus on the thermal complexes at Rovinari, Turceni and Craiova;
- The Bank will seek to partner with strategic investors or other IFIs and the local capital markets for the energy companies being privatised. These include the natural gas production companies and electricity distribution followed by gas transmission companies and oil and oil products transmission companies. Expansion of gas storage facilities to accommodate increasing domestic demand, and construction and rehabilitation/upgrade of such oil and gas pipeline infrastructure as the Nabucco gas pipeline (from Turkey to Austria) and the oil pipeline from Constanta to Omisalj through Serbia are also important transition challenges that could be supported with investments from the Bank, and are particularly crucial in the context of the on-going support for the creation of a more integrated regional energy market;
- The Bank will assist the on-going spin-off and ultimate corporatisation and restructuring of the petroleum and gas service sector, including upstream oil and gas field services, and mid-stream / refining services.
- The creation of a functioning Regional Energy Market in South East Europe will be a priority. To this end, the Bank will continue to seek opportunities in financing high-voltage interconnections to neighbouring countries, as well as support the high-tech infrastructure required to operate the electricity market and facilitate trade. The Bank will also support equity investments in both the grid operator, Transelectrica, and the electricity trading exchange, OPCOM, in order to safeguard the neutrality of these institutions (who are meant to provide services indiscriminately to market operators) as well to provide credit for clearing of trades in order to boost trading in the region;
- The Bank will continue to explore opportunities for energy efficiency components in all its projects, particularly in General Industry energy-intensive sectors. It will consider Credit Lines for sustainable energy projects (energy efficiency and renewable energy) in Romania in combination with Technical Co-operation and Co-financing Packages. The Bank will aim to develop projects involving Energy Service Companies ("ESCOs") in particular in public sector buildings where there is significant potential for energy savings. It will also contribute to the wider use in Romania of the emission trading mechanisms by helping Project Sponsors with their development of Joint Implementation projects, and designing and implementing Green Investment Schemes (sale by a State such as Romania to another of a portion of its allowance in Carbon Credits (Assigned Amount Units) and use of all or part of the proceeds thereof to finance or co-finance emission reduction project or activities contributing to lower emissions in the host country);
- On renewable energy the Bank will seek to maintain a policy dialogue with the Regulator in order to improve the regulatory environment and financial incentives offered to renewable energy projects. Furthermore, the Bank will seek to invest in rehabilitation of existing hydro power capacity.

3.2.1.2 Transport:

In the transport sector the Bank has signed 7 loans committing about €340 million for total project costs of €1.58 billion. One of the projects is non sovereign. The Bank mobilised parallel commercial co-financing for one port project and IFIs parallel co-financing and EU grant funding for four projects in the roads and railways sectors.

Roads. While the Government has taken steps in the last two years to seek to further engage the private sector in roads, the procurement process for such schemes has not, ultimately, been acceptable to the Bank. In addition, major road construction in the state sector has been awarded without competitive tender. In 2005 the Government indicated that it will not award contracts on this basis in the future. The challenge for the Bank is to support the Government in this decision, to assist in identifying appropriate projects and in implementing them in accordance with best practice, both for state-sector and for private-sector projects. The public sector continues to require support for capacity and institution building to enhance its capability in project selection and preparation, conduct of tenders, negotiations and ongoing administration. These activities may be financed by separate facilities, or dedicated tranches of facilities relating to larger projects.

The Bank is leading a working group, established by the Government with the participation of EU, WB, IMF and EIB, whose aim is to allow the Government to select the proper structure and tendering process for a public-private partnership in the road sector to be tendered out and negotiated during the second half of 2006. The Bank will continue to support both commercialisation and privatisation of operational activities, such as road maintenance, and to encourage the participation of the private sector in these activities. In addition, the Bank will be supportive of moves towards full cost recovery in the sector: this may initially involve the implementation of tolling for Heavy Goods Vehicles (HGVs), as is done in Austria and Germany and as currently contemplated in Slovakia and the Czech Republic.

Railways. The Bank will continue to support the restructuring of the railways sector and the commercialisation of the companies which were established as a result of the unbundling of the Romanian Railways Company. These newly established companies continue to require support in terms of investment financing and institution building. In this respect, the Bank is currently preparing a loan for the newly incorporated distributor of electricity to the Romanian railway system which will support the efficient operation of the company and will contribute to the transfer of skills in business planning and procurement, and to setting standards for corporate governance and business conduct. The Bank is also interested in the pre-privatisation financing of CFR Marfa, the national rail freight operator, in the form of debt or equity.

The Bank will consider financing of rolling stock renewal for private railway operators, as well as financing, on a non-sovereign basis, the investment plans of national passenger and freight operators. In addition, the replication of an existing project to improve the amenity of five main regional railway stations or the provision of finance in support of further commercialisation including concessions of main stations will also be considered. Furthermore, railway infrastructure continues to require rehabilitation and the Bank will look to support the rehabilitation of the Trans-European Network corridors and complementary investments.

Ports and the Maritime Sector. The Bank will continue to support restructuring and development in the sector, as well as encourage commercial behaviour in view of the economic importance of the ports sector to the Romanian economy. The Bank will seek a balanced approach, with private and public sector investments, and will support those initiatives which transfer freight to river transport from land-based means, where these are economically viable and environmentally sound, as river traffic generally has a lower environmental impact than land-based traffic. The Bank has lent to the Constanta Port Authority on a commercial basis to finance the development of a trans-shipment terminal, to allow cargoes to be transferred between sea-going and river vessels. The Government intends to replicate this transaction for other public sector borrowers who are sufficiently financially sound to be eligible for commercial finance. The transaction requires the Port Administration to introduce modern business planning techniques and to align its tariff system with international practice.

Air Sector. The main airports: Henri Coanda Otopeni - Bucharest, Baneasa Bucharest, Timisoara and Constanta are owned by the Government, while the others are owned by the local counties. The Bank will support the investment plans of the airports to allow them to cope with anticipated traffic increases, post EU accession, and will encourage future private sector involvement in the sector. The Bank will consider a commercial loan to Henri Coanda Otopeni Bucharest airport and, at a later stage, a sovereign project for regional airports in order to promote commercial behaviour of airport management and attract private sector participation.

3.2.1.3 Municipal and Environmental Infrastructure:

To date, the Bank has signed 18 loans in the municipal sector committing about €375 million for total project costs of €1 billion. The Bank mobilised commercial co-financing for six of these projects. The European Union provided grant co-funding of €370 million under its ISPA programme for water and waste-water related projects for nine of these projects

The Bank has a strong reputation in Romania as a provider of local government and municipal utility financing as a result of its work in supporting the corporatisation and commercialisation of local utilities and the decentralisation of public finances to support local financial autonomy and sustainability. Building on its financing of priority investments in the water sector through sovereign loans Municipal Utilities Development Programme (MUDP) I and II, the Bank has become the first non-sovereign provider of debt in 1999 and a co-financier for European Union funds Municipal Environmental Loan Facility (MELF), as well as the lead financier for public private partnerships (Apa Nova Bucharest).

The Bank will maintain strong relationships with the central government, local and regional authorities and the European Commission, and is developing a pipeline of projects in the run up to accession suitable for co-financing with the Cohesion and Structural Funds when they become available to Romania. Small municipalities will be supported directly, while very small ones will be assisted through credit lines provided to local commercial banks.

Key priorities for the Bank in the municipal sector will be as follows.

- Drawing on experience gained through the Apa Somes transaction, the Bank will support regionalisation in the water sector, working with credit-worthy utilities to extend their operations into smaller cities and rural areas, which have not had the benefit of finance to upgrade and restructure their water operations and find it difficult to access funding. The Bank will also seek to develop regional projects in other sectors, in particular regional roads and solid waste.
- The Bank will continue to provide finance, including under MELF, to support European Union accession-oriented projects with a strong transition impact, such as the Bacau and Arges Solid Waste projects.
- The Bank will seek to build on existing relationships to move into new sectors, which will include urban transport, regional roads, municipal parking, district heating and solid waste, and possibly the social sector within the parameters of the Bank's mandate. Developing transactions in new sectors will present the Bank with significant transition opportunities to develop institutional capacity as well as to support commercialisation and structural reform. In addition, supporting clients in preparing projects to international standards developing institutional capacity to tap into Cohesion and Structural funds will be an important component of these projects.
- The Bank will continue to support clients interested in using public private partnerships as a means to attract private sector know-how and increase efficiency. To ensure that tendering procedures are done on the most open and transparent basis, the Bank will need to mobilise technical co-operation funds for its clients.
- The Bank will move toward non-guaranteed structures to finance the investment needs of local utilities and public companies, backed by service contracts and support agreements with local authorities.
- The demand for municipal debt is evolving as evidenced by the increased interest in both commercial banks and the bond markets in Romanian municipalities. The Bank will explore ways to support municipalities in developing both general obligation and revenue bonds. The Bank will provide finance to smaller municipalities and in addition, it will seek to deepen the municipal credit market through Small and Medium Municipalities facilities with local commercial banks willing to take municipal risk.

3.2.2. Corporate Sector

With privatisation nearing completion and related FDI tapering off, the Bank will increasingly focus on greenfield projects with international investors. At the same time the Bank will seek to identify local enterprises which the Bank can support in their restructuring in order to improve their competitiveness and allow them to withstand the competition levels characterising the single market. The financial instruments the Bank will utilise will be expanded to include local currency financing wherever feasible. A special focus will be given to equity, quasi equity and subordinated securities.

The Bank has identified the forestry sector as one of the sectors which are attracting FDI as Romania has an important and very valuable wood resource. At the same time the Bank is working within its policy dialogue with the central and local authorities on the improvement of forestry management to ensure regular and transparent wood supply to all investors. Another sector which is enjoying growing interested is agribusiness and in particular food processing and dairy sector.

Another priority is an expansion of the advisory services to local management teams of private enterprises through the EBRD’s Turnaround Management (TAM) and Business Advisory Services (BAS). TAM has undertaken 92 projects in Romania, utilising approximately € 5.9 million of Donor funding. TAM will continue to assist enterprises on the basis of the importance of their problems, not only to the enterprises themselves, but also to the social well-being of inhabitants of given regions.

There is an urgent need for advisory services to address the real and immediate needs of local enterprises to overcome short term practical problems hindering expansion. The BAS programme will address these issues, initially focusing on the enterprises’ ability to raise finance, and in the medium term broadening its mandate to more general and management and business consultancy. The broad focus of the Romanian BAS Programme will be on enterprises with 10 - 100 employees, located outside the capital city.

In terms of specific industries, the operational priorities will be:

Agribusiness:

- In the food processing sector the Bank will continue to support foreign strategic investors and will further identify and offer selective support to successful, local food and drinks processing companies with the capacity to sustain long-term investment programmes and the related financing.
- In the food retail sector the Bank will seek to provide further long-term financing to strategic investors given the importance of modern retail formats for the Romanian primary agriculture as well as food processing chains.
- In the grain sector, the Bank will seek to support local and foreign investors in their effort to improve grain related infrastructure, and in particular grain terminals and storage facilities. The Bank will also continue its dialogue with the Romanian government in order to accelerate the introduction of commodity based financing, such as the Warehouse Receipts Programme, expected to support the enhancement and development of the Romanian agricultural sector in the future, providing the necessary seasonal working capital to farmers.
- The Bank will continue to work closely with local banks in order to promote lending to agribusiness SMEs applying financial schemes adapted to the sector's specifics such as Rural Finance credit lines.

Property and Tourism:

To date, the Bank has invested € 54 million in 4 projects in the Property and Tourism sector in Romania. Since the beginning of 2004, the real estate market in Romania has advanced and now commercial banks are more comfortable providing senior debt financing to international developers of Class A office buildings, retail and logistic centres in Bucharest. There remains, however a need for equity capital to help increase the liquidity in the market. Additionally, senior debt is still not readily available for the financing of hotels and other tourism related facilities and a limited number of real estate projects, particularly with local or smaller international developers.

The Bank's focus in the real estate sector in Romania will be to

- continue to offer selective support to projects that promote better logistic/warehouse, retail and residential developments primarily through mezzanine and equity instruments;
- support institutional quality real estate in regional cities;
- support the development of secondary markets by encouraging the growth of established property companies and by creating sector specific funds; and
- support the development of hotels and other tourism facilities in response to the needs of the capital city and the regions of the country.

Additionally, through recent equity investments in property development companies such as Europolis II and real estate funds such as Accession Fund and Global Property Fund the Bank is expected to invest indirectly in projects in Romania during the next two to three years.

Telecommunications:

The Romanian telecommunication market was fully liberalised in 2003 and the regulatory environment has been significantly changed since. Currently in the telecoms market, including local and long distance voice telephony, there is a healthy competitive environment. The challenge faced now by the sector is to significantly increase access to communications networks, provide new services, and improve the overall quality of the service. The Government decided in the national Strategy for Communications and IT issued in 2004 to privatise by end 2006 the last state owned telecom operator, SN Radiocomunicatii (Radiocom), and to restructure and privatise the postal services provider, Posta Romana.

The main objectives of the Bank will be to further increase access to communication services via the incumbent and alternative operators' networks, to improve the quality of service, to encourage the emergence of innovative and advanced communication services in the context of the newly liberalised market and to further increase competition. EBRD will support the private participation in the development of the Romanian telecoms market by offering pre-privatisation assistance to SN Radiocomunicatii and to the postal services operator Posta Romana.

3.2.3. Financial Sector and SMEs

To date, the Bank has signed 63 transactions including sub-projects in the financial sector committing about €718 million for total project costs of €1.35 billion. Twelve projects are equity participations in local banks, five projects are investments in equity funds and three are participations in non banking financial institutions. Out of the 37 loans in the banking sector, five are financing mortgages, one is dedicated to municipal financing, 17 are covering the SME sector, five are financing leasing and nine are general line of credit with local banks. Six facilities are assisting trade finance.

During the last 2-3 years, there has been good progress in privatisation and restructuring of the banking sector. There are currently only 2 banks left that are majority state-owned (Eximbank and Savings Bank (CEC)), while Banca Comerciala Romana (BCR) is partially owned by the state but under the process of privatization. However, the main transition challenges in the financial sector as identified in Section 2.2.2 include: expanding the range of products and the volume of financing made available to the real economy, especially in local currency; and taking into consideration the role of local capital markets, the completion of the privatisation of the banking sector (mainly of BCR and CEC (Savings Bank)), and the follow through on reform of the pension system. The specific objectives of the Bank in the sector are as follows:

Banking: The activities of the Bank will target the increase of financing to the real sector and will concentrate mostly on the following strategic goals:

- *Financial Intermediation.* Broadening the range of products and the availability of financing for the private sector is a key goal. Intermediation levels in Romania lag both EU levels and those of the recent entrants to the EU. The institution building process in the financial sector, while well underway, is not complete and the Bank will continue to support the further development of the sector. This will flow from a combination of continued participation in the equity of selected banks and broadening the availability of products through Romanian financial institutions.

- *Significant Privatisations.* Supporting the efforts of the Romanian authorities in the privatisation of the two large banks where the state still has significant participations, BCR and CEC. State-owned banks still account for some 33 per cent of the total assets of the Romanian banking sector. The privatisation of BCR, the largest of the three remaining banks with the Romanian state as shareholder, was re-launched in July 2005. In October 2005, two bidders were selected for further negotiations, namely Erste Bank and Banco Comercial Português. BCR accounts for about 26 per cent of the total assets of the Romanian banking system as of June 2005. The Bank, together with the IFC, took a minority stake in BCR of 12.5 per cent plus one share each, within a revised privatisation strategy articulated in two phases. EBRD and IFC implemented an Institutional Building Plan within BCR in preparation for a full privatisation by end-2006. The Bank may also support selected merger and acquisition opportunities among local private banks.

- *Larger scale implementation of new products for SMEs, Small Municipalities and individuals.* The Bank will continue to pursue opportunities to participate in equity funds that invest in Romanian SMEs. It will also continue to provide mortgage facilities to selected banks, with due attention to consumer protection issues. One new priority will be to extend loans denominated in local currency for mortgages, municipal financing and possibly financing for private enterprises to support their energy efficiency investments. At the same time, the Bank will work on the establishment of a secondary mortgage market with the first mortgage bond issue in 2006. The Bank assisted 4 local banks and a mortgage lending company (Domenia Credit) to develop standard mortgage products that can be used either for the issuance of mortgage bonds or, in the medium to long-term, for securitisation of mortgage receivables. In parallel with these new capital market products, the Bank will also consider further supporting specialised mortgage institutions.

SME and Micro Enterprises: Supporting the development of sustainable provision of finance to Micro, Small, and Medium Enterprises (MSMEs). The Bank will continue to provide SME and micro-lending facilities to partner banks under the framework of the EU/EBRD SME Finance Facility and the US/EBRD SME Financing Facility, as well as through ProCredit Bank, the dedicated microfinance bank in which the Bank has a 16.53 per cent stake. The Bank will continue its fruitful cooperation with KfW as a partner in ProCredit Bank and use the leverage of both institutions in the improvement of the overall legal and regulatory framework for micro-lending. Following the approval of the microfinance law, the Bank will also lend to viable and regulated Non-Bank Microfinance Institutions (NBMFIs) in order to reach MSEs nationwide and in particular in rural areas. Credit lines to selected non-bank MFIs will be combined with technical assistance to strengthen these financial intermediaries and ensure sustainability of lending to MSMEs.

Non-Banking Financial Institutions:

- *Pension System.* The reform of the state pension system was slower than anticipated for various reasons such as inadequate legislation, lack of funds, Romania having one of the largest numbers of pensioners per active workforce in CEE, etc. The reform targets the creation of a three-pillar system with the introduction of both voluntary and mandatory pension schemes, away from the current pay-as-you-go system. The relevant legislation was adopted in 2004, amended in 2005, with the launch of Pillar III funds provisionally scheduled for January 2006. The Bank will support the development of private pension legislation offering stability and safety to the sector while delivering quality services to the future retirees The Bank may support private pension fund companies on a selected basis.

- *Insurance.* Insurance penetration remains very low as, in addition to the lack of an insurance culture, legislation and supervision still need improvements. The Bank will consider opportunities for further potential investments in the sector and will support the introduction of new products in the market such as health insurance. The development of the insurance and pension sectors is also important to the creation of a growing pool of long-term savings which in turn will support the growth of local capital markets, such as the corporate bond market and a secondary market for instruments backed by receivables from products such as mortgages (as mentioned above) and leasing.
- *Further Increase of Leasing Activities.* With full support from the Bank through 5 transactions, leasing has already proved an attractive financing option for the modernisation of fixed assets and business expansion. The activities of leasing companies have grown considerably. Through the EU Phare programme, the Bank will continue to provide local leasing companies with long-term funding necessary to lend to small and medium sized enterprises for investment projects with longer payback periods.
- *Consumer Finance.* The Bank will also look at the early stages of the development of the consumer finance sector and potentially support the development of this sector with debt and equity financing.

Private Equity:

- The private equity market in South Eastern Europe is underdeveloped. Consequently, private equity activities in Romania are supported primarily by private equity funds which are either (i) regional funds focused on the New Member States but have an ability to invest in the next accession countries like Romania and Bulgaria; (ii) regional funds focused on greater South Eastern Europe in general (occasionally including Ukraine and Turkey); or (iii) South Eastern European funds with limited regional scope (e.g. Bulgaria and Romania only or focus on the former Yugoslav republics). It is anticipated that in the coming years there will be an increasing number of new funds with specific focus on South Eastern Europe. Because of its accession, Romania will be one of the primary investment countries of those funds. The Bank has a strong commitment to the creation of a private equity fund industry in Romania and its neighbouring countries much as it has had in the past in the New Member States. The Bank will consider working with fund managers experienced in transition economies as well as with new entrants which potentially would require the Bank to take higher risks and engage more actively in the monitoring process.
- Romania does not yet have a group of local fund managers who have sufficient skills and experience to manage funds with a primary focus on small companies with local entrepreneurs. The Bank will seek to select the fund managers to broaden this skill in the industry, based on the experiences and lessons learned in the New Member States. Key to long term success will be to blend experienced and often expatriate investment officers with local staff to build depth and ensure sustainability.
- It will also be important to support the development of local institutional investors such as pension funds, long term insurance assets, and advanced savings schemes that can assume higher risk and make longer term investments. However, as noted earlier, the development of these domestic institutions has been rather slow to date. Further, the pace of skill transfer for domestic investors is developing more slowly than for service providers (fund managers) whose expertise has been augmented by the talent available in more developed markets.

3.3 Environmental Implications of the Bank’s Strategy

The proposed priorities for Bank investments include a number of sectors that are associated with environmental risk, such as electricity generation, oil and gas production and transportation, agribusiness, tourism, and port rehabilitation and expansion. The sectors that provide the most challenges also typically provide opportunities to introduce international standards of practice, improve efficiency and management, and increase transparency and public awareness.

Particular attention on social issues will need to be paid to large scale tourism and agribusiness projects. Tariff affordability of electrical distribution and heating projects, and water and wastewater treatment will be of particular importance for the 25 percent of the population who live in poverty. The evaluation of labour issues, particularly in the area of discrimination, will be important for any project where large scale employment or retrenchment is envisioned.

Proposals are also included in the strategy for environmentally based projects in areas of municipal and environmental infrastructure, such as urban transport, district heating and solid waste management, and in energy efficiency credit lines.

Given Romania's commitment to the *EU acquis communautaire*, the Bank's environmental focus will be to support its continuous progress. Reflecting on the Bank's extensive portfolio and pipeline projects in Romania, the Bank's environmental due diligence work is likely to be diverse, and there are likely to be concrete environmental opportunities in sectors such as energy, energy efficiency, and industry.

3.4 Co-Financing, Pre- and Post-Accession Funds

The Bank will continue to be a major catalyst in mobilising co-financing, both commercial and donor. Some of the largest transactions in the pipeline, such as the Constanta By-Pass with total financing needs of € 649m, allow for co-financing from EU and other IFIs. Syndications and co-financing opportunities will be strongly sought in order to address, among other things, the environmental or social components of projects, as is the case in the Water and Waste Water Project Facilities, where close cooperation with the ISPA programme is ongoing.

Experience has shown that the absorption of EU funds is a challenge. The European Commission, the EIB and EBRD are launching the Joint Assistance for Preparing Projects in European Regions (JASPERS), a major policy initiative to help preparing high-quality projects which are eligible for EU structural and cohesion funds. It will also enable the Commission to approve well-prepared projects more quickly. JASPERS will be complementary to the project preparation work carried out by national and local authorities.

The Bank has proven that it can be a key success factor in overcoming capacity constraints and helping to ensure absorption of EU funds in a timely and well-managed way.

3.5 Policy Dialogue

The Bank will continue an active policy dialogue with the government and the authorities on the material factors impeding the business environment in order to attract higher FDI such as the labour code, law enforcement and administrative capacity. The Bank is a member of the Foreign Investment Council and of several sectoral task forces.

- The labour code has been identified as one of the main areas that needs adaptation to enhance the business environment and the Bank will work closely with both foreign and local business representatives in order to make the labour code more competitive.
- Continue the policy dialogue in the energy sector to achieve the finalisation of the sector's privatisation and to strengthen the independence of the regulators in power and gas.
- Support the government in its endeavours to develop an effective PPP model to help overcome the shortages in local infrastructure and budget constraints by involving the private sector in the financing and maintenance of all types of infrastructure projects.

- The administrative capacity for effective absorption of EU funds needs to be improved and particular focus will be given to project preparation for pre- and post-accession structural and cohesion funds.
- The development of capital markets, especially of private pension funds needs to be supported. In this respect, it is worth noting that without any action to broaden the tax base (tax revenues are among the lowest in the region at 30 per cent of GDP) prospects for the capitalisation of pension funds remain slim.
- Improve forestry management to ensure transparent and regular supply of wood to all wood processing companies.

4. OTHER IFIS AND MULTILATERAL DONORS

Donor and IFIs Co-operation

The Bank's co-operation with other IFIs in Romania has been intensive and regular for many years. These included consultations and meetings among donors, either on general issues or specific projects, in order to avoid unnecessary duplication of efforts and to increase the complementary nature of the interventions. As a result there is a high level of co-ordination among the Bank, the EU Delegation, the EIB, the IMF, and the World Bank and also common objectives to support on-going public sector restructurings and enhancement of the public administration, environmental improvement, and infrastructure development. The heads of the IFIs in Romania meet on a monthly basis to co-ordinate their activities and share information. The draft 2005 Country Strategy for Romania has been discussed with and endorsed by the local representatives of these organisations.

4.1 European Union (EU)

Total EU multilateral grant-financed pre-accession assistance to Romania is running at € 912 million for the year 2004. Projections for 2005 and 2006 lead to an overall financial envelope of about € 929 million for 2005, and € 997 million for 2006. In the Roadmap for accession for Romania and Bulgaria of November 2002, the European Commission has foreseen a substantial increase of financial assistance in the year 2004 (+20%), 2005 (+ 30%), and 2006 (+ 40 %), conditional upon Romania making progress in implementing the road map and improving the capacity of managing EU funds. The assistance is channelled through several programmes:

PHARE: Since 2000, the PHARE programme aims at providing support to help Romania prepare for accession to the EU in three main areas: institution building and effective implementation of the "acquis communautaire" (2/3) and economic and social cohesion (1/3). The PHARE allocation to Romania amounts to € 279 million for the budget years 2002 and 2003, € 435 million for 2004, and forecasted € 427 million for 2005 and € 468.5 million for 2006. PHARE's total allocations to Romania during the period 1990-2005 amounted at end August 2005 to about € 2.6 billion, with contracts worth about € 1.8 billion.

ISPA *(Instrument For Structural Policies For Pre-Accession)****:*** The ISPA programme which commenced in 2000 supports major environmental and transport infrastructure projects. Over the past five years, Romania has committed the total yearly allocated budget for 2000 to 2005, increasing from € 238 million to € 348 million, and fairly balanced between environment and transport sectors. The total amount of the 61 ISPA Financing Memoranda signed (40 Environment (35 investment and 5 TA measures), 20 Transport (11 investments, 9 TA) and 1 Institution Building for both sectors) is € 2.8 billion out of which, 74% is the ISPA Grant of € 2.1 billion.

The implementation of the ISPA projects started in mid 2000. A total of 125 contracts (87 for Environment, 33 for Transport and 5 for Institution Building) amounting at € 959.6 million being concluded to date. The contracting rate versus the total amount committed is now 40.25%.

SAPARD *(Special Action Programme for Agriculture and Rural Development):* The SAPARD programme supports agricultural and rural development measures. Starting with 2000 Romania's annual allocation from SAPARD varies between € 150-160 million. By the end of August 2005 the credits granted for SAPARD projects amount to € 650 million. These include 180 projects worth € 102 million related to the improvement of processing and marketing of agricultural and fishery products, 607 projects worth € 484 million related to the development and improvement of rural infrastructure, 13 projects worth € 1.7 million related to technical assistance, 440 projects worth € 43.32 million related to investments in agricultural holdings, and 335 projects worth € 19 million for diversification of rural areas.

JASPERS *(Joint Assistance for Preparing Projects in European Regions):* This new initiative launched by European Commission, EIB and the EBRD will be complementary to the project preparation work carried out by national and local authorities (See 3.4)

4.2 European Investment Bank (EIB)

The EIB has a loan portfolio of € 4.3 billion signed at 31 December 2005 in Romania, out of which 49 per cent has been disbursed. The portfolio includes projects in transportation (roads, airport and railways), energy, telecommunication, municipal utilities and SMEs. In 2004, EIB approved 6 projects with the total commitment of € 411 million. In 2005, EIB approved 6 projects with a total commitment of € 950m. In the next years, EIB will focus on projects in the sectors of transport, energy, environment, Foreign Direct Investments, as well as social projects and telecommunication. The Bank will closely co-operate with EBRD in the field of PPPs in Romania as well as in the other sectors mentioned above.

4.3 International Monetary Fund (IMF)

The 10th and most recent agreement with the IMF was approved on 7 July 2004. This is a precautionary Stand-by Arrangement (SBA) valid for 24 months, which the Romanian authorities do not intent to draw from. It is intended to be the last agreement concluded by Romania with IMF, after which only annual consultations being expected. The agreement is based on the commitments made by Romania on macro economic policies for 2005-2006 and gives access to funds of SDR 250 million (US$ 367 million), to be used only in case of certain unpredictable economic events. The SBA is now off-track following failure to reach agreement on the second and third reviews.

In addition to the SBA, IMF has supported the transition in Romania by substantial technical assistance in several fields, in over 40 missions since 1990. The assistance from Fund’s experts was focused on a number of key fields among which: tax reform, modernization of the central bank and of the banking system, elaboration of a market-oriented legal structure, training courses and improvement of statistic data collection and reference.

4.4 World Bank Group

Since 1991 the total WB assistance, including the IFC and MIGA operations, exceeded US$ 6 billion and aimed at helping Romania’s transformation to a market economy, while complementing it with measures to protect the most vulnerable in the process.

The current IBRD assistance totals about US$ 1.51 billion and is represented by 20 loans, one guarantee operation, six non-lending activities and nine grants.

FY 2005[18] was a special year both in terms of new commitments, as well as new business products. Approx. US$ 786 million was added to the portfolio, representing commitments under new seven loans. A new business product was also developed, namely the partial risk guarantee, used in the Banat and Dobrogea Electricity Distributions Privatization Partial Risk Guarantee (US$ 76.7 million).

The IBRD assistance was geared around development objectives that can be grouped in three broad categories: (i) the promotion of sustainable private sector led growth; (ii) the poverty reduction and human development; and (iii) the improvement in governance and institution building. Changes in the commitment composition through FY 2006 will reflect the evolving country priorities, now centred on the EU integration agenda.

Romania joined IFC in 1990. Since then, IFC has committed US$ 849 million, including US$ 241 million in syndicated loans, to finance over 30 projects across a variety of sectors. IFC’s portfolio in

[18] World Bank fiscal year is 1 July – 30 June.

Romania stands at US$ 418 million, investments being spread across the country's most important sectors including banking, leasing, housing finance, infrastructure, pulp and paper, general manufacturing, oil and gas, telecommunications, retail and health care. The good co-operation with the EBRD is reflected in joint projects such as Distrigaz Sud, BCR and Banc Post.

For 2006-2009, the World Bank engagement will be anchored on the EU integration process, the strategic framework that would guide future lending focusing on facilitating economic integration and social cohesion with the EU. Several areas have been identified as key priorities: completing EU accession reforms, infrastructure, health, education, and agriculture. Another critical element is the development of operational synergies with other development partners, in particular with the European Commission, European Investment Bank, and EBRD.

4.5 U.S. Agency for International Development (USAID)

USAID began to operate in Romania in 1991. Since its establishment, USAID's total allocation for Romania has surpassed US$ 450 million. In 2005, USAID's annual budget for Romania was US$ 30 million, of which US$ 10 million was allocated to support activities in the area of economic development. The goals of these activities include: to reform the legal and regulatory business environment; to support organizations and government agencies that assist businesses; to increase the competitiveness of private Romanian enterprises; and to promote the growth of investment and trade with the U.S. US$ 9 million was allocated for activities strengthening democratic governance and rule of law, namely activities designed to: increase citizen participation in local decision-making and to improve the delivery, effectiveness, and accountability of public services; promote civic activism, philanthropy, volunteerism, and the inclusion of vulnerable groups in public discourse; improve the dialogue between civic groups and members of Parliament; promote debate on electoral reform; and improve the accountability of elected representatives. USAID's rule of law program supports strengthening the independence of the judiciary. In 2005, USAID allocated US$ 6.5 million for assistance to improve child welfare and health services. Also in 2005, USAID allocated more than US$ 4 million to assist Romania in relief and post-disaster revitalization efforts after the massive flooding that occurred in the spring and summer of 2005.

USAID funding for assistance to Romania is scheduled to phase-out in 2007, with activities being implemented through 2008.

ANNEX 1 - POLITICAL ASSESSMENT

Compliance with Article 1

Romania is committed to the principles of multiparty democracy, pluralism and market economics in accordance with the conditions outlined in Article 1 of the Agreement Establishing the Bank. Romania has made significant progress in recent years in consolidating institutions guaranteeing democracy, the rule of law, human rights and the protection of minorities. The past three elections (1996, 2000 and 2004) all resulted in changes in both government and the president. Parliamentary and presidential elections in November and December 2004 were judged by international monitors to be generally free and fair, although certain procedural irregularities were noted and observers expressed concern about the apparent political bias of some media coverage in the campaign period.

Political Accountability

Romania's political leaders are held accountable to the electorate through regular elections to both the executive and legislative branches of government. While the President has exclusive powers over foreign policy, the Prime Minister is the centre of political power in Romania. The bicameral Romanian Parliament comprises the lower house, the Chamber of Deputies, and the upper house, the Senate. In accordance with Romania's 1991 Constitution, both houses are directly elected for a four year term on the basis of proportional representation and national party lists. The Romanian president is also elected directly, with a minimum threshold of 50 per cent in the first round of voting, followed by a second-round run-off between the two most successful candidates. According to Constitutional amendments approved by national referendum at the same time as the 2004 presidential election, the President's term in office was extended from four to five years. This electoral system generally provides an adequate system of checks and balances between the legislative and executive branches. However, despite progress achieved in 2005, important reform challenges remain. In particular, executive interference in judicial affairs continues to be a problem.

According to the OSCE's Office for Democratic Institutions and Human Rights (ODIHR), Romania's parliamentary and presidential elections in 2004 were generally free and fair, offering Romanian voters "a wide and genuine choice" and characterised by a "vigorously contested" election campaign with lively debate. While noting that the print media were "virtually unrestricted" in their campaign coverage, the OSCE expressed concern about reported pressures on journalists to limit their criticisms of the government, and highlighted several inconsistencies and vague provisions in Romania's Election Law. A monitoring mission organised by the non-partisan Romanian Pro Democracy Association (APD) found widespread irregularities during the first round of presidential voting, particularly in the use of supplementary voting lists. The Electoral Commission introduced reforms in this area of the electoral legislation following the first round, and APD reported only limited irregularities in the second round of voting.

In the November 2004 parliamentary elections the ruling Social Democratic Party (PSD) won a small plurality of seats in both houses, with 113 out of 332 seats (34.0%) in the Chamber of Deputies and 46 of 137 seats (33.6%) in the Senate. The Romanian Humanist Party (PUR), which had run in alliance with the PSD, secured an additional 19 seats in the lower house and 11 in the Senate. The opposition, which included the centre-right National Liberal Party (PNL) and the centrist Democrat Party (DP), unified under the umbrella of the Truth and Justice Alliance (DA Alliance) and won 112 seats (33.7%) in the Chamber of Deputies and 45 seats (32.8%) in the Senate. This generated expectations that the National Union alliance of the PSD and PUR would form a government.

However, in the presidential poll the following month the Democrat Party leader Traian Basescu succeeded in a surprise second-round defeat of PSD leader Adrian Nastase. The PUR then defected from the National Union alliance, and signalled that it was willing to join the DA Alliance. President Basescu asked Calin Popescu Tariceanu of the Alliance to form a government. The resulting coalition, which includes the PNL, DP, PUR—which changed its name to Conservative Party in May 2005—and the Democrat Union of Hungarians in Romania (UDMR), has a slim majority in the Senate and depends on the support of national minority and independent deputies in the Chamber of Deputies.

Prime Minister Tariceanu formed a young cabinet—marking an important break with most of Romania's post-communist governments, which tended to reflect the former communist hierarchy—and declared his government's intention to pursue a reform programme oriented to ensuring Romania's accession to the EU in 2007, including fiscal consolidation, restructuring and privatisation, and combating corruption.

Romania has an active and politically engaged civil society which is strongly committed to Romania's integration with Euro-Atlantic economic, political and security structures. Influential actors from Romanian civil society played an important role in the 2004 elections, with domestic NGOs involved in various aspects of the electoral process. In particular, the Campaign for a Clean Parliament (CPC) and the non-partisan Pro Democracy Association (APD), provided important information to voters on the candidates and the conduct of the elections.

Rule of Law

Successive Romanian governments have made accession to the EU in 2007 a top priority, necessitating important and far-reaching reforms to the judiciary and public administration and intensified activity in combating corruption. According to numerous national and international surveys, corruption remains a serious and widespread problem in Romania. However, the Government has undertaken a series of recent initiatives to combat corruption, including the introduction of anti-corruption legislation. In March 2005 the Government adopted an ambitious Strategy and Action Plan to reform the judicial system, which has been implemented according to schedule.

There are some indications that corruption levels have been reduced over the past three years. According to the EBRD Business Environment and Enterprise Performance Survey (BEEPS), indicators for administrative corruption in Romania improved between 2002 and 2005. The World Bank/IFC *Doing Business* surveys also found that Romania is among the top anti-corruption reformers. Nevertheless, according to the BEEPS levels of corruption in Romania remain above the average for the advanced transition countries (the EU-8 countries) and are higher than levels of corruption in established market economies. Also, the number of successful prosecutions remains low, particularly for high-level corruption.

Amendments to the Romanian Constitution undertaken in 2003 declared the judiciary a separate and equal branch of the state and made the Superior Council of the Magistracy responsible for ensuring the independence of the judiciary. However, in practice, some questions regarding executive interference in judicial affairs remain. An official survey conducted by the Ministry of Justice in 2004 found that a majority of judges have come under political pressure while exercising their judicial functions. In addition, there is a chronic shortage of well-trained judges with large dockets, and as a result a large percentage of civil adjudications are overturned on appeal, which undermines public confidence in the competence of the judiciary.

Civil and Human Rights

Civil and human rights in Romania are generally well established and defended by the state. The international NGO Freedom House in 2005 rated Romania as "free," placing it on a peer-level with Serbia and Montenegro and slightly less free than Bulgaria and Croatia. However, Freedom House also noted a slight deterioration in Romania's political rights as a result of the flaws in the first round of presidential voting. The primary areas of concern about civil and human rights in Romania are the freedom and independence of the media and the protection of the rights of minority nationalities.

The Romanian media are characterised by considerable pluralism and a diversity of political viewpoints. The 1991 Constitution enshrines freedom of expression and of the press, the 2001 Law on Free Access to Information of Public Interest provides journalists with statutory powers to request official information, and the Election Law prescribes that all contestants should have access to the broadcast media during the official campaign period. However, during the early 2000s, there were concerns about the state of media freedom, as extensive political and economic control was perceived to have led to increasing self-censorship and decreasing media independence. In its 2005 *Freedom of the Press* survey, Freedom House ranked Romania 13th among the 27 transition countries and 104th of 194 countries globally, with a rating of 'Partly Free'. Particular problems included extensive government funding and the favouring of pro-government media outlets by state-owned companies, which in turn generated significant self-censorship among Romanian journalists.

After repeated calls throughout 2004 for improvements to Romania's media environment, the European Commission in October 2005 noted "positive developments in the area of freedom of expression." The Commission report highlighted the adoption of an Emergency Ordinance in May 2005 which makes the procurement of advertising space by public institutions more transparent, and reform to the Parliamentary Investigation Committee undertaken in the summer of 2005 to strengthen the management of state-owned television, print and radio media. Nevertheless the Commission report concluded that significant further reforms are necessary to ensure the security of investigative journalists and ensure the transparency of media ownership.

In a recent report the COE commended Romania's progress in implementing programmes to support national minorities, including through the establishment of a Council of National Minorities and the right of special minority representation in Parliament. However, the COE concluded that the situation of the Roma is still an area of concern. The European Commission applauded the Government's adoption of new statutes on national minority protection in May 2005, but also expressed concern about the lack of progress on implementation of Romania's 2001 Roma Strategy.

External Relations

The major aim of Romanian foreign policy since 1990 has been to secure membership in NATO and the European Union. NATO invited Romania to open membership discussions at its summit meeting in Prague in 2002, the protocol on membership was signed in May 2003 and Romania joined NATO in March 2004. Romania has also made significant progress in its EU accession negotiations since 2000, and signed an accession treaty, together with Bulgaria, on 25 April 2005. The treaty envisages Romania's accession in January 2007, although of the slow progress in reform over the past year has raised questions regarding the formal accession date. In October 2005 the European Commission issued a report urging Romania to accelerate its efforts and tackle the sensitive areas where reforms have advanced at a slower pace recently. A final decision on whether Romania meets the requirements for joining the Union in January 2007 will be taken by the European Council in April or May 2006 when a new report will be drafted.

Romania's pro-European foreign policy has had positive effects on its regional relations. Hungarian-Romanian relations have shown a steady improvement since the mid-1990s. Relations with Serbia and Montenegro and Bulgaria have been consistently good. Reunification with Moldova, which has a population that is 60 percent ethnic Romanian, has lost support in both Romania and Moldova but bilateral relations are steadily improving. Romania's relations with Ukraine were affected by the demarcation of borders along the Danube river in 2004, which had implications for drilling rights in the Black Sea. However, since the Yushchenko administration came to power in the winter of 2004-2005, Romanian-Ukrainian relations have improved.

ANNEX 2 - LEGAL TRANSITION

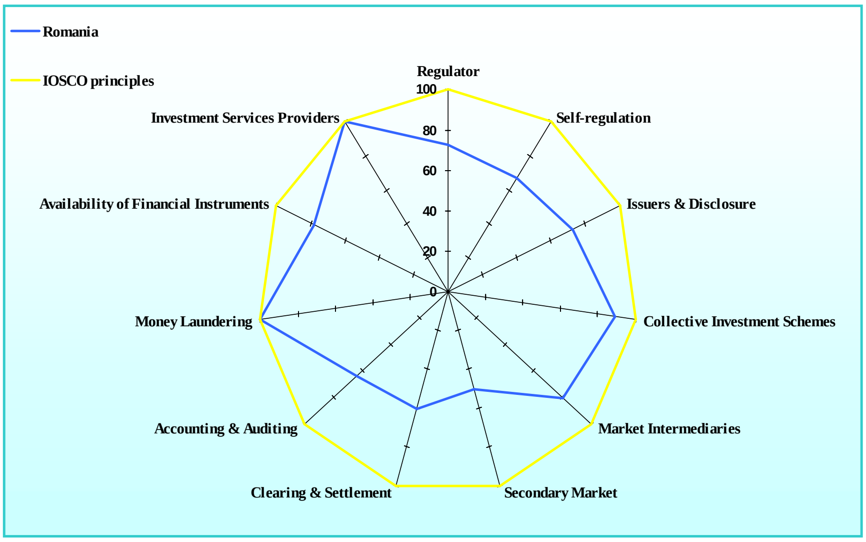
The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of laws (also referred to as “effectiveness”). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for the Romania, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

Capital Markets

The main legislation concerning securities markets is the law no. 297/2004 (the “Capital Market Law”), which entered into force on 28 July 2004. The Capital Market Law unifies the previous regulations contained in different acts into a single piece of legislation and transposes a number of EU directives ahead of Romania’s anticipated entry to the EU in 2007.

The National Securities Commission of Romania (*Comisia Naţională a Valorilor Mobiliare* or “CNVM”) is the securities market regulator. CNVM was established in October 1994 as an independent regulator, accountable to the Parliament, with the authority to impose fines and issue legally binding regulations. CNVM’s revenues are derived from fees/tariffs on various capital markets operations and are not dependent upon the state budget. CNVM performs supervision of the stock exchange and financial intermediaries, provides oversight of takeovers and also has the authority to enforce insider trading provisions and disclosure requirements.

Quality of securities market legislation –Romania (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO’s *Objectives and Principles for Securities Regulations*. The fuller the ‘web’, the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

In its 2004 Securities Market Legislation Assessment, the EBRD benchmarked the Romanian Securities Markets legislation against the “Objectives and Principles of Securities Regulation” published by the International Organization of Securities Commissions (IOSCO). The result demonstrated that Romanian legislation is in “medium compliance” with international standards. As shown in the chart above, major flaws appeared present in the “Secondary Market”, “Clearing and Settlement” and “Accounting and Auditing” sections. However, the preliminary results of a recently prepared update of the assessment pointed to several significant legislative improvements in the Romanian legal framework during 2004-2005. Notwithstanding this progress, there remain some flaws in the framework, including not requiring disclosure of nominee and indirect ownerships; the absence of specific provisions granting shareholders the right to petition the regulator; and the absence of a clear mandate for CNVM in the protection of shareholders rights. Finally the law is still unclear on the reporting duties in the case of related party transactions. On the procedural side, certain implementing regulations required by the Capital Market Law have yet to be adopted. Other issues dealing specifically with corporate governance are detailed in the following section.

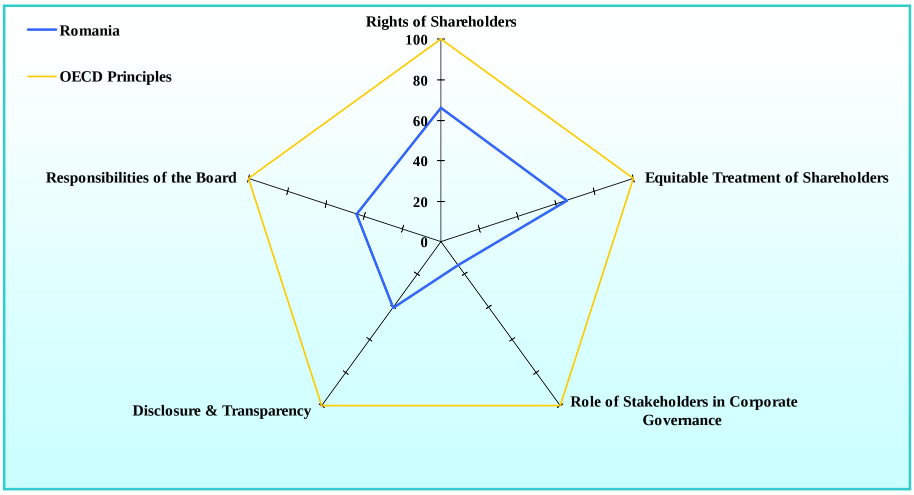
Company Law and Corporate Governance

The principal laws dealing with corporate governance are the law no. 31/1990 (the "Companies Law") and the Capital Market Law – see above. The Companies Law was adopted in November 1990, amended several times, and finally published in revised form in the Official Gazette in November 2004.

In 2003-2004, the EBRD benchmarked the relevant Romanian corporate governance legislation against the "Principles of Corporate Governance" published by the OECD. Results demonstrated that the Romanian legislation in this area is in "low compliance" with the OECD principles. As shown in the chart below, flaws are present in all sections assessed. When considering the "Right of Shareholders", the relevant legislation does not require that shares should be fully paid before they can be transferred and shareholders agreements are not required to be disclosed. Further, cross-shareholdings are not regulated and the relevant legislation is silent on the possibility for shareholders to include additional items on the agenda or to submit questions to the management and obtain a reply before the general meeting is held.

With reference to the "Equitable Treatment of Shareholders", the relevant legislation leaves to the by-laws a possibility of granting differing voting rights to shareholders. Significant transactions are not subject to specific approval procedures and related party transactions are not sufficiently regulated.

Quality of corporate governance legislation – Romania (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2004 assessment

When considering the "Role of Stakeholders in Corporate Governance", the relevant legislation is silent on employee participation in profits. With respect to "Disclosure and Transparency", only listed companies are required to prepare quarterly financial reports and reports on consolidated basis. In addition, there are no clear provisions concerning the appointment of external auditors and statutory auditors are no longer required for public companies. In this respect, a positive development would be a requirement to have the external auditor appointed by the general shareholders meeting, following nomination by the non-executive audit committee. Finally the corporate documentation available by relevant legislation to shareholders is limited. In the section dedicated to the "Responsibilities of the Board", the assessment revealed that the law is very general on board duties and responsibilities and is silent on issues such as independent director, remuneration and compensation committees or audit committees.

In 2005, the EBRD launched a survey to test the effectiveness of corporate governance (how the relevant legislation works in practice). A case study dealing with related-party transactions was designed and investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and how it was possible to obtain compensation where damage or loss was suffered. The effectiveness of the relevant legislation was then measured according to four principal variables: institutional environment, enforceability, complexity and speed. The survey showed certain deficiencies in all variables. Actions available to minority shareholders are generally clearly provided for by the legislation but it is hard to find case law offering guidance to legal provisions. The time needed to conclude proceedings is usually reasonably short although it is very easy for the defendant to delay the procedure. Enforceability of judgements is improving but is still a problematic issue. Finally, corruption is still reported as a problem.

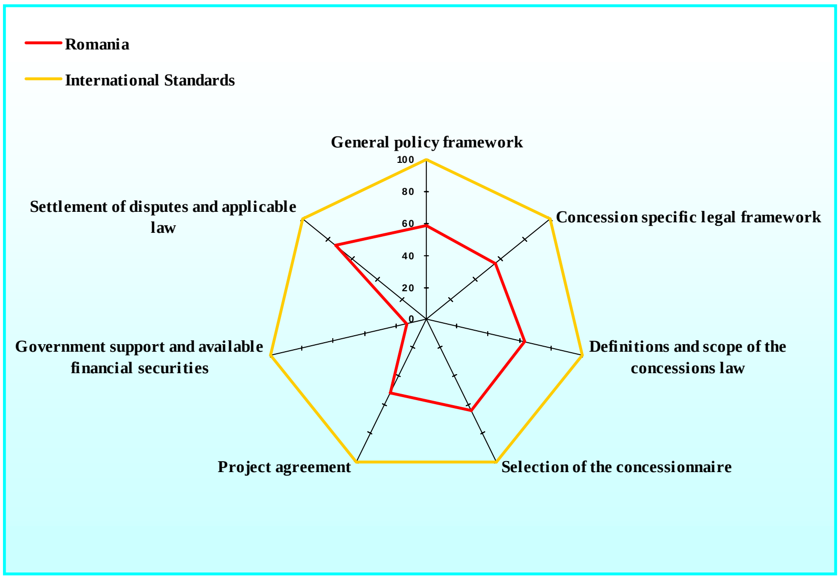
Concessions

Rules governing concessions are contained mainly in the following laws: the Concession Law, dated 1998 (the “Concession Law”) and the Government Ordinance on Public-Private Partnership Agreements, dated 2002 ("PPP Ordinance"). Both laws were completed with Methodological Norms (Regulations). Both laws have been amended in October 2004 by the “Law on the Modification and the Amendment of the Government Ordinance on Public-Private Partnership Agreements n°16/2002 and Concession Law n°219/1998”. In addition, special rules applicable to particular sectors can be found in respective sector specific laws (e.g. transport law, mining law, gas sector law). Various recent government programmes and statements, in addition to the adoption of the 2002 PPP Ordinance and announcements of public tenders, suggest that public private partnerships are being encouraged in Romania. There exists, albeit implicitly, a general policy framework for promoting Private Sector Participation in public projects (“PSP”) in Romania, with PSP being a part of the government strategy on the acceleration of public administration dated 2001. The Concession Law contains a non-exhaustive list of property, services and activities that can be subject to concession, limiting the term of a concession to 49 years. The Concession Law and its implementing regulations cover concession procedures, distinguishing between public tender and direct negotiating. Pursuant to the Concession Law, concessionaires are selected on the basis of an open tender procedure (with or without the pre-selection procedure), though competitive dialogue and direct negotiations can be used in certain specific cases. Pursuant to the PPP Ordinance, investors are selected on the basis of a competitive dialogue only. Sectors/activities where concession is possible are clearly listed in the Concession Law, though not in the PPP Ordinance. Foreign or Romanian entities are entitled to be a concessionaire/private investor under both acts.

The Concession Law allows for a unilateral modification of a contract by the authorities for exceptional reasons related to national interests, providing for compensation of damage or loss to an investor in such cases. The Concession Law applies equally to domestic and foreign investors and sets out basic minimum requirements for a concession contract. Some of the shortcomings of the Concession Law include a lack of clarity on whether international arbitration may be chosen for dispute resolution and conflicts among provisions in the Concession Law, special sector laws, procurement law, municipal regulations and the PPP Ordinance. While the Concession Law provides a regime for services concessions, the PPP Ordinance regulates works concessions on a differing basis. Given that possible partnerships often include elements from works and services, a certain amount of legal uncertainty arises with respect to which procedure applies to such hybrid partnerships.

However, in spite of some controversies the regime generally seems to work and concessions have been granted on both state level and municipal level on the basis of the regime.

Quality of concession legislation –Romania (2005)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2005

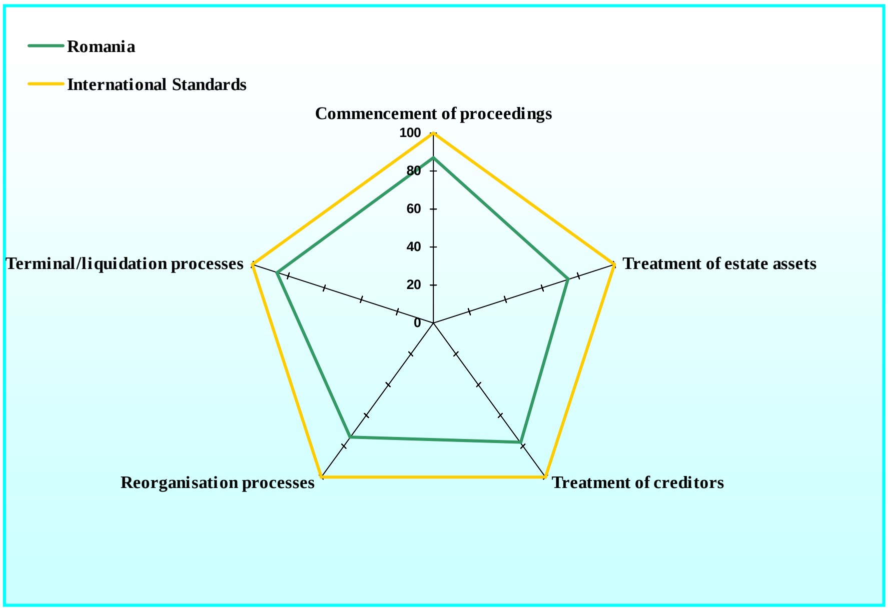
The EBRD recently undertook an Assessment of Concessions Laws to evaluate the extensiveness of concession regimes throughout the EBRD's 27 countries of operations (the laws on the books only, rather than how they work in practice). This assessment revealed that Romanian laws in this area were in "medium compliance" with internationally accepted standards. As can be seen from the above graph, the area that is least developed and in greatest need of reform is availability of security interests and provision of state support. In fact, comparing these results with those of the previous year's survey, the "government support and available financial securities" category actually got worse. Other areas have shown little or very slight improvement on last year's results. In conclusion, there is still much room in Romania for improving its concession related/PSP enabling legislation, notably, by making it more consistent and clearer in its application.

Insolvency

Bankruptcy and insolvency are governed primarily by The Law Regarding the Procedure of Judicial Reorganisation and Bankruptcy (as amended, 2002) (the "Insolvency Law"), one of the leading insolvency laws in the EBRD's countries of operations. In the EBRD's 2003-04 Sector Assessment Survey, which measured the compliance of insolvency legislation with international standards in 97 different areas, the Insolvency law was one of only 6 laws to receive an overall score of "high compliance".

The graph below demonstrates the level of compliance of the Insolvency Law across five critical areas in insolvency legislation. The outside line of the graph represents full compliance with critical international standards (rather than a "perfect law") and the inside line charts the Insolvency Law's score.

Compliance of the Romania's Insolvency Law with International Standards
Quality of insolvency legislation – Romania (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment Project, 2003/4

The Insolvency Law is one of few in the EBRD's countries of operations that provides a special fund to deal with bankrupt estates that have insufficient assets to fund a liquidation. Although reorganisation processes were the weakest area of performance for this legislation, it still provides for a relatively well-designed reorganisation process. As described above, however, achieving a high score is not intended to suggest that a given law is perfect but, rather, that it substantially complies with a number of critical elements of international standards in insolvency. Even a law that achieved "full compliance" would still require improvement. Similarly, the Insolvency Law could be significantly improved in a number of ways. Among other things, the law could provide a clearer (and therefore more transparent) description of what precisely constitutes insolvency; it could provide more clarity regarding the effect of bankruptcy on the rights and remedies of secured creditors; and it could provide provisions for set-off.

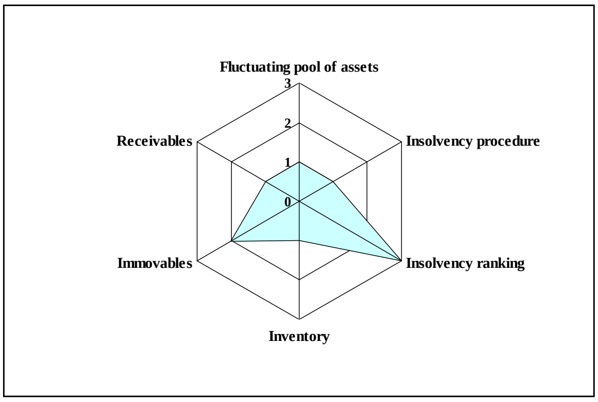
Assessing the state of insolvency legislation in Romania provides only part of the picture. It is also necessary to look at the practical functioning of the insolvency regime (the "effectiveness" of the regime).

The EBRD 2004 Legal Indicator Survey on Insolvency which examined the effectiveness of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies revealed that for debtors and creditors seeking to commence insolvency proceedings, it is relatively easy to determine which court such proceedings should be commenced in. For both parties, however, the process is too slow. The survey highlighted a relatively unique feature of Romania's insolvency regime. It is one of the few EBRD countries of operations to have a more effective regime from the creditor's point of view rather than the debtor's. While this may be good news for creditors, it suggests that reorganisations (and therefore business continuity and job preservation) will be difficult for debtors to achieve. In general, the survey revealed a large "effectiveness" gap (the difference between the quality of the legislation and the effectiveness of the insolvency regime in practice) in Romania. This gap suggests that Romania's legal system is not able to effectively implement such a good law and underscores the need for further reform work to be done to strengthen courts and other institutions that implement insolvency legislation.

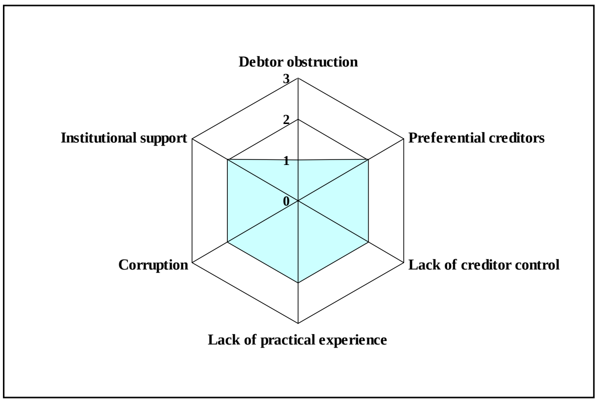
Secured Transactions

Obstacles to charge enforcement process – Romania (2003)

Scope



Process



Note: The fuller the web, the more serious the problems are in each of the respective categories. “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

***Source*: EBRD Legal Indicator Survey 2003**

Taking security on movable assets is governed by the law entitled ‘Legal Treatment of Security Interests in Personal Property’ (hereafter “Law on Security Interests”), published in the *Official Gazette* of 27 May 1999 and entering force when the 'Electronic Archive of Security Interests in Personal Property' was established in late December 2000. The Law on Security Interests allows for the creation of possessory and non-possessory charges, subject to registration in an electronic registry (the Archive). The Law is generally very modern and market oriented, providing a number of features required for economic efficiency of the credit market, such as the possibility to describe generally the charged assets and to cover the whole of the enterprise. While the system was initially seen as alien to Romanian legal tradition there are indications that practitioners are growing comfortable with it. The Archive is centrally managed by the Ministry of Justice, with various organisations (e.g. Chamber of Notaries, Chamber of Commerce) serving as licensed registrars.

The Law on Security Interests offers out-of-court, creditor driven, modes of enforcement. However, as shown in the EBRD Survey on Enforcement of Charges, conducted in 2003 (see graph above), enforcement is hampered by a deficient institutional framework. Further deficiencies are the lack of certainty of the position of the secured creditor in bankruptcy and the fact that certain claims, such as tax claims, may supersede that of a registered chargeholder. However, on balance, Romania has nevertheless established one of the most advanced regimes for secured transactions in EBRD region and should be praised for its achievements in this respect.

Taking security over immovable property (real estate) is, in contrast, reported to be problematic, mostly because of problems associated with the functioning of the Land Register. The Foreign Investors Council has published a White Book earlier this year raising this issue, among others, as hampering foreign investment in Romania.

Telecommunications

The telecoms sector in Romania is currently regulated by the National Regulatory Authority for Communications (ANRC) and governed by a legislative framework comprising Emergency Government Ordinance No. 79/2002, Government Ordinance No. 591/2002, together with Law 239/2005. This primary framework is also supplemented by numerous regulations governing, *inter* *alia*, access and interconnection, data protection, numbering, and significant market power designation and obligations.

While the Ministry of Communications and Information Technology (MCIT) maintains responsibility for sector policy, ANRC has responsibility for day-to-day policing of the telecom market and implementation of the legal and regulatory framework. ANRC is an independent sector authority and has responsible for monitoring and supervising operators to ensure compliance with obligations set out in laws, regulations and licences. ANRC is also responsible for the management of numbering resources and for the issuing of licences. MCIT and ANRC work with the Inspectorate General for Communications and Information Technology in managing and allocating the radio spectrum.

The above legislation provided for the formal liberalisation of the Romanian telecoms market as of January 2003, with the abolition of exclusive rights of ROM Telecom (the incumbent former monopolist operator). The implementation of market liberalisation resulted both from Romania's membership obligations of the World Trade Organisation and Romania's accelerated efforts to join the European Union (EU), expected in 2007 and requiring transposition of standard EU telecoms legislation into general Romanian law.

Despite a slow start with legislating and implementing sector reforms, Romania has made notable progress towards harmonisation with the EU regulatory framework for telecoms within a short space of time. Progress has been significant in a short space of time and has been sufficient for the EU telecom chapter to be closed in December 2004, without transition requests. Market competition, which is the most important driver of sector development, is gradually beginning to take hold following 2003 liberalisation. Meaningful progress in this respect will require full implementation of a modern regulatory framework, harmonised with the EU standards. This will necessitate effective full implementation of access and interconnection provisions, the promotion of pro-competitive pricing, and ensuring ANRC remains appropriately empowered and adequately resourced (both in financial and human terms) to execute its duties.

ANNEX 3 -ENVIRONMENTAL ISSUES

Romania continues to face severe environmental problems concerning air, water and soil pollution, which require large investments and the participation of both public and private sector. Serious air pollution from power stations and other industrial plants, especially heavy metals, motor vehicles, and domestic heating need to be further addressed. Significant improvements are still needed in the fields of waste management, improving access to the sewage treatment plants, improving drinking water quality; reducing underground water pollution; enforcing integrated pollution prevention and control.

Harmonisation with EU Environmental Law

The primary focus of Romania's environmental authorities is to harmonise with the EU's environmental law (the 'Acquis Communautaire'). The *Acquis Communautaire* comprises over 200 legal acts covering different areas such as water and air pollution, waste and chemical management, nature protection, industrial pollution management and noise protection. The European Commission's 2004 Regular Integration Report on Romania's progress towards accession with the European Community reports good progress in a number of areas. For example, legislation has been adopted on procedures relating to environmental impact assessment and strategic environmental impact assessment and guidelines for public consultation have been developed. Progress is also reported in adoption of air quality legislation, aligning drinking water legislation with the EU, development of integrated permitting systems, and first attempts to create a pollutant emissions register. In 2004, the Ministry of Environment and Water Management (MWEP) was de-linked from the Agriculture Ministry. A national environmental protection agency was established and a special body for inspection and enforcement was created.

Romania has requested additional transition periods for ten directives, such as the Integrated Pollution Prevention and Control Directive, the Solvents Directive, and the Large Combustion Plant Directive. Full implementation of the environment *acquis* is anticipated to still pose a major challenge, particularly on the amount of investment needed. The current planning is that existing industrial activities will have 10 years (2006-2015) to comply with the new provisions for integrated pollution control, and then facilities that are not able to comply by 2015 will be closed.

Ozone Protection and Climate Change

Romania is a party to the Convention for Protection of the Ozone Layer and the amendments. The MWEP has established an Ozone Secretariat and set goals of reducing its ozone-depleting substances to zero between 2005 and 2015. The intention is to comply with the Montreal Protocol prior to EU Accession.

With regards to climate change, Romania ratified the Framework Convention on Climate Change and the Kyoto Protocol. Romania is now working on Joint Implementation (JI) projects with the Netherlands in co-generation and district heating for the municipality of Targoviste. Switzerland and Norway have also agreed to finance JI projects. Further work is necessary by Romania to develop institutional capacity and the legal framework for assessing greenhouse gas emissions by 2007 in order to take full advantage of JI opportunities.

Protected Areas and Biodiversity

In order for Romania to fully integrate into the European Union, full compliance with EU legislation is necessary. The Romanian government is working with UNDP and the Global Environmental Facility (GEF) to identify priorities to come into compliance with requirements under the UN Conventions for Biological Diversity, Climate Change and Land Degradation to which it became a Party in 1994. Romania is also a Party to the Bonn Convention on the Conservation of Migratory Species of Wild Animals and to the Ramsar Convention on Wetlands of International Importance

Especially as Waterfowl Habitat. Biodiversity and nature protection have been priorities for Romania, with its world-recognised areas of natural beauty and critical habitat. There are over 800 natural protected areas in Romania, which represent over 5% of the national territory. These include three biosphere reserves, two Ramsar sites (protected wetlands), and 18 landscape reserves.

The Danube Delta was declared a UNESCO World Heritage Site and Biosphere Reserve in 1990, setting aside an area over 500,000ha for environmental protection. It is also a Ramsar Site, and is managed by the Danube Delta Biosphere Reserve Authority. Over 300 species of birds have been recorded in the Danube Delta, including cormorants, white and Dalmatian pelicans, storks, herons, and other endangered or vulnerable species.

In 2000, Romania initiated the Emerald Project to implement the Bern Convention on Conservation of Natural Habitats and Wild Life in Europe. The Council of Europe has provided technical and financial assistance for this initiative.

Environmental Education

Romania has taken a number of initiatives in environmental education. In 2005, the Carpathian Danubian Centre for Geoecology organized a 6th edition of a national workshop on "Partnership Developing Environmental Education", in Bucharest. The programme was initiated by the Foundation for Environmental Education with the support of the European Commission and works to integrate principles of sustainable development, ISO14001 and environmental management into the curriculum.

Public Consultation and Environmental Organisations

Romania ratified the UNECE Convention on Access to Information, Public Participation and Access to Justice in Environmental Matters (Aarhus Convention) in 2000, and the UNECE Convention on Environmental Impact Assessment in a Transboundary Context (Espoo Convention) in 2001. Legislation is being implemented to meet the requirements under the Conventions. In 2004, UNDP and GEF Danube announced support of a regional project on access to information and public participation in environmental decision-making for the five countries of the Danube Region. Projects will provide information to the public and reinforce community involvement.

More work needs to be done in order to have meaningful consultation or public participation, as most requirements are for information disclosure. A PHARE technical assistance project is helping to develop guidance on public consultation in EIA requirements and training. A civil society organisation (StrawberryNet) reports that there are 168 registered environmental groups active in Romania.

In 2003, a Pollutant Release and Transfer Register (PRTR) was developed as a result of co-operation between the Ministry of Waters and Environmental Protection and non-governmental organizations (NGOs). This will provide information on pollutants to the general public.

Capacity-building projects

The World Bank has developed a number of capacity-building projects in Romania that affect environment and health, particularly in the mining and health sectors. The Mine Closure and Environmental and Socio-Economic Regeneration project (US$120 million) is helping to decommission and rehabilitate closed mining sites in line with EU accession requirements, and the Socio-Economic Regeneration component will create 25,000 new jobs in mining regions.

The World Bank's Hazard Risk Mitigation and Emergency Preparedness Project is assisting the Government in reducing the country's vulnerability to natural disasters and catastrophic mining accidents, by improving the capacity for disaster management and emergency response.

UNDP and GEF are implementing a capacity building project (2003-2006) in energy efficiency which will help reduce greenhouse gas emissions by working with local banks to find commercial financing for energy efficiency projects.

Recent Environmental Initiatives on EBRD Projects

To help address the legacy of environmental damage and encourage environmental quality improvements, the Bank incorporates environmental action plans into most projects. The Bank has worked with Mittal Steel Galati (formerly known as Ispat-Sidex) on a plan to come into compliance with EU accession criteria for integrated pollution control. Mittal made a preliminary assessment in 2004 and obtained 18 months (i.e. July 2006) for the development of a detailed programme to meet EU standards. For other projects, such as Terapia and Petrom, the Bank is closely monitoring the implementation of environmental action plans to clean up past liabilities.

Constanta Port Development: In 2004 the Bank provided a loan to support the National Company Maritime Ports Administration in the construction of a barge terminal in the Port of Constanta. As part of wider Port Commercialisation Enhancement Programme, separately prepared for the Ministry of Public Works, Transport and Housing in 2001, an environmental action plan (including health and safety issues) was developed to address key environmental risks and the provision of good environmental management in the port area. A range of environmental related projects are currently being implemented to ensure future improvements throughout the port, in particular those related to IMO Marpol Convention 73/78; the Strategic Action Plan for the Rehabilitation and Protection of the Black Sea and the EU Directive on port reception.

Constanta By-Pass: The Bank is currently studying a project to support the construction of a north-south by-pass to the town of Constanta, linking with the Bucharest-Constanta Motorway, the rehabilitation of ten strategic bridges (crossing the Danube or the Danube – Black Sea Channel) in the Constanta county and repairs and rehabilitation works to 98 flood-damaged locations (road sections and bridges) on the national roads network. The Bypass is likely to have a significant positive effect on on the traffic problems on the town, in particular the rerouting of heavy port traffic away from Constanta town centre and the provision of a free-flowing route for heavy tourist traffic from Bucharest and the North of Romania to the popular sea side resorts south of Constanta.

Arad, Sibiu and Brasov Urban Transport Programme: The Bank has invested in a range of urban transport infrastructure projects in the cities of Arad, Sibiu and Brasov**.** The projects are intended to improve the urban transport infrastructure through investment in tram track rehabilitation, purchase of new city buses, street upgrading in the city and traffic signal modernisation. All of these projects will contribute to improving public transport reliability, safety and efficiency, will reduce congestion, and help maintain the market share of public transport, with associated air quality benefits.

Distrigaz Sud: In 2005 the Bank supported the privatisation of the gas distribution company Distrigaz Sud. Along with ensuring compliance with Romanian and EU environmental, health and safety requirements, there are likely to be considerable environmental opportunities associated with the privatisation process. The potential for Greenhouse Gas reduction will also be significant given the investment programme to replace the existing network of old and corroded leaking pipelines.

Financial Intermediaries: EBRD continues its work with financial intermediaries in Romania who are required to implement the Bank's environmental risk management procedures to ensure that FI clients are, at a minimum, complying with national standards for environment, health, safety and labour. Since the 2003 EBRD Strategy for Romania, EBRD has undertaken a number of training seminars in Romania with local banks to assist them in understanding the nature of the Bank's environmental procedures and how to implement the procedures correctly. These seminars have been aimed both directly at credit staff and also at in-house training units who then provide training to credit staff on a more regular basis. Trained FIs include Miro Bank, Bank Post, Alpha Bank, Alpha Leasing, Bank Romanesca, BT Leasing, OTP Romania (former Robank) and Banca Comerciala Romana.

ANNEX 4 – SELECTED ECONOMIC INDICATORS

Romania

	2000	2001	2002	2003	2004	2005 *Estimate*	2006 *Projection*
Output and expenditure				*(Percentage change in real terms)*			
GDP[1]	1.8	5.3	4.9	5.2	8.3	5.5	5.3
Private consumption	0.2	6.4	3.0	7.1	10.1	11.7	na
Public consumption	20.4	-1.9	2.1	4.6	na	4.3	na
Gross fixed capital formation	4.6	6.6	8.3	9.2	10.8	7.6	na
Exports of goods and services	23.9	10.6	16.9	11.1	na	5.9	na
Imports of goods and services	29.1	17.5	12.1	16.3	na	17.1	na
Industrial gross output, unadjusted series	8.2	8.2	6.0	3.1	5.3	na	na
Agricultural gross output	-14.1	22.7	-3.5	3.0	na	na	na
Employment				*(Percentage change)*			
Labour force (end-year)	0.2	-1.2	-12.0	-1.6	na	na	na
Employment (end-year)	-0.1	-0.6	-13.7	-0.1	na	na	na
				(In per cent of labour force)			
Unemployment (end-year)[2]	7.1	6.6	8.4	7.0	6.2	5.5	5.5
Prices and wages				*(Percentage change)*			
Consumer prices (annual average)	45.7	34.5	22.5	15.3	11.9	9.4	7.5
Consumer prices (end-year)	40.7	30.3	17.8	14.1	9.3	9.2	7.0
Producer prices (annual average)	53.4	40.3	24.5	19.6	18.6	na	na
Producer prices (end-year)	50.3	32.6	20.1	20.0	16.3	na	na
Gross average monthly earnings in economy (annual average)	46.9	48.9	27.3	23.6	22.5	13.9	na
Government sector				*(In per cent of GDP)*			
General government balance	-3.8	-3.5	-2.0	-2.0	-1.4	-1.0	-1.4
General government expenditure	34.8	33.4	32.3	32.3	30.5	na	na
General government debt	22.7	23.2	23.3	21.3	18.5	15.0	na
Monetary sector				*(Percentage change)*			
Broad money (M2, end-year)	38.0	46.2	38.1	23.3	39.9	10.1	na
Domestic credit (end-year)	11.4	26.9	39.8	50.4	15.3	32.1	na
				(In per cent of GDP)			
Broad money (M2, end-year)	23.0	23.2	24.7	24.4	27.0	25.8	na
Interest and exchange rates				*(In per cent per annum, end-year)*			
Discount rate	35.0	35.0	29.0	20.4	18.0	na	na
1-week BUBOR	47.3	39.3	20.0	21.4	17.8	na	na
Deposit rate (average)	32.4	26.2	18.4	10.8	11.3	na	na
Lending rate (average)	53.2	45.7	36.7	26.2	25.8	na	na
				(Lei per US dollar)			
Exchange rate (end-year)	25926.0	31597.0	33500.0	32595.0	29067.0	29000.0	na
Exchange rate (annual average)	21692.7	29060.9	33055.5	33200.1	32636.6	28741.9	na
External sector				*(In millions of US dollars)*			
Current account	-1,347	-2,349	-1,573	-3,455	-5,468	-8,893	-11,200
Trade balance	-1,684	-2,969	-2,613	-4,465	-6,612	-9,543	na
Merchandise exports	10,366	11,385	13,869	17,627	23,518	27,516	na
Merchandise imports	12,050	14,354	16,482	22,092	30,130	37,060	na
Foreign direct investment, net	1,051	1,154	1,080	2,156	5,020	5,300	4,500
Gross reserves, excluding gold (end-year)	2,497	3,960	6,145	8,106	13,462	13,869	na
External debt stock	10,271	12,470	15,227	19,694	22,798	20,800	na
				(In months of imports of goods and services)			
Gross reserves, excluding gold (end-year)	2.1	2.9	3.9	3.9	4.8	4.1	na
				(In per cent of exports of goods and services)			
Debt service[3]	25.9	21.1	18.9	17.8	19.9	16.2	na
Memorandum items				*(Denominations as indicated)*			
Population (end-year, million)	22.4	22.4	21.8	21.7	21.7	21.7	21.7
GDP (in millions of lei)	803,773,100	1,167,242,800	1,512,616,800	1,890,778,300	2,387,914,300	2,755,238,328	3,118,860,907
GDP per capita (in US dollar)	1,652	1,792	2,100	2,620	3,376	4,411	na
Share of industry in GDP (in per cent)	27.3	28.2	28.4	28.4	na	na	na
Share of agriculture in GDP (in per cent)	11.1	13.3	11.3	11.7	na	na	na
Current account/GDP (in per cent)	-3.6	-5.8	-3.4	-6.1	-7.5	-9.3	-9.3
External debt - reserves (in US$ million)	7,774	8,510	9,083	11,588	9,336	6,931	na
External debt/GDP (in per cent)	27.7	31.0	33.3	34.6	31.2	21.7	na
External debt/exports of goods and services (in per cent)	84.7	93.5	94.0	95.4	84.1	68.2	na

1 From 2001 growth rates are calculated by the National Statistical Institute using a new methodology that complies with European standards of national accounting.

2 Officially registered unemployed. According to the ILO methodology, the rate of unemployment in Romania is lower than the official one.

3 Debt service payments on private and public external debt.

ANNEX 5 - SIGNED BANK OPERATIONS AND PIPELINE

ANNEX 5A – EBRD OPERATIONS TO DATE

(as of 31 October 2005, € millions)

Op ID	Op Name	Regional/Direct	Signing Date	Total Project Value	EBRD Finance	Debt	Equity	Operation Stage
5049	AIG New Europe Fund	Regional fund investment	29/06/99	41.0	7.1	0.0	7.1	Repaying
19104	APA NOVA Water Treatment Plant Project	Direct	19/12/02	155.2	55.4	55.4	0.0	Disbursing
4607	Advent Central & Eastern Europe II - Regional Fund	Regional fund investment	18/12/97	10.0	3.5	0.0	3.5	Repaying
34563	Advent Central & Eastern Europe Successor Fund	Regional fund investment	25/06/04	49.6	7.5	0.0	7.5	Disbursing
6	Agribusiness Development Project	Direct	14/09/92	58.5	58.5	58.5	0.0	Completed
318	Alpha Bank Romania (portage equity)	Direct	20/07/93	17.2	1.7	1.7	0.0	Completed
3415	Alpha Bank Romania Equity Investment	Direct	17/12/97	15.0	1.8	0.0	1.8	Completed
35664	Arad Urban transport programme	Direct	23/06/05	20.0	15.0	15.0	0.0	Signed
32168	Arctic Partial Write off (OPID 3283)	Direct	14/10/97	1.8	1.8	0.0	1.8	Completed
3283	Arctic Privatisation and Modernisation	Direct	14/10/97	41.8	14.5	8.0	6.5	Repaying
33287	Astral Telecom	Direct	18/09/03	33.6	5.8	5.8	0.0	Repaying
345	Athenee Palace, Bucharest	Direct	04/11/94	51.2	11.9	11.9	0.0	Repaying
31768	Banc Post Mortgage Loan	Direct	14/05/03	20.7	20.7	20.7	0.0	Repaying
35426	Banc Post Mortgage Loan II	Direct	03/12/04	20.0	20.0	20.0	0.0	Disbursing
2369	Banca Agricola Credit Line Extension	Direct	06/12/95	12.5	12.5	12.5	0.0	Completed
95	Banca Agricola IT Loan	Direct	09/12/94	21.1	5.6	5.6	0.0	Completed
29023	Banca Comerciala Romana Mortgage Loan	Direct	14/01/03	50.0	50.0	50.0	0.0	Repaying
29327	Banca Comerciala Romana Pre-Privatisation	Direct	04/11/03	190.5	97.8	0.0	97.8	Disbursing
33716	Banca Romaneasca - Equity Investment	Direct	01/02/05	5.3	5.3	5.3	0.0	Disbursing
6121	Banca Transilvania (equity)	Direct	09/10/01	6.8	6.8	0.0	6.8	Disbursing
35197	Banca Transilvania - Capital Increase	Direct	25/05/04	1.3	1.3	0.0	1.3	Disbursing
32209	Banca Transilvania - Credit Line for SMEs	Direct	05/06/03	5.0	5.0	5.0	0.0	Disbursing
36132	Banca Transilvania - Second capital increase	Direct	07/06/05	2.2	2.2	0.0	2.2	Disbursing
35505	Banca Transilvania - Syndicated Loan	Direct	17/12/04	22.5	7.5	7.5	0.0	Disbursing
34597	Banca Transilvania Mortgage Loan	Direct	19/12/03	10.0	10.0	10.0	0.0	Disbursing
33633	Bank Austria/HVB FW - HVB Bank Romania S.A. - Mortgage	Direct	03/12/04	10.0	10.0	10.0	0.0	Disbursing
1758	Bank Coop	Direct	12/12/94	4.5	4.5	4.5	0.0	Completed
4453	Bank Post Convertible Loan	Direct	10/07/98	23.4	15.0	15.0	0.0	Disbursing
4260	Baring Communications Equity	Regional fund investment	05/12/97	6.4	1.3	0.0	1.3	Repaying
27040	Billa	Regional fund investment	20/03/03	62.9	7.9	7.9	0.0	Completed
4542	Black Sea Fund	Regional fund investment	26/08/98	19.2	7.0	0.0	7.0	Repaying
26174	Black Sea Fund - Capital Increase	Regional fund investment	31/05/02	9.5	2.5	0.0	2.5	Disbursing
36483	Brasov Urban Transport Project - City Loan	Direct	28/10/05	18.0	15.0	15.0	0.0	Signed
36207	Brasov Urban Transport Project - Company Loan	Direct	28/10/05	18.0	15.0	15.0	0.0	Signed
26313	Bucharest Multi-Sector Project (Municipality)	Direct	24/04/03	27.5	16.3	16.3	0.0	Disbursing
33932	Bucharest Multi-Sector Project (Radet)	Direct	24/04/03	33.6	17.8	17.8	0.0	Signed
22	Bucharest Wholesale Market	Direct	09/06/94	32.2	20.8	20.8	0.0	Repaying
1653	Bucharest-Pitesti Motorway Upgrading and Tolling Project	Direct	05/08/96	86.3	44.3	44.3	0.0	Repaying
12936	CFR City Stations Enhancement Project	Direct	04/04/03	27.9	24.0	24.0	0.0	Disbursing
667	Capital SA	Direct	29/04/93	5.1	1.7	0.0	1.7	Completed
31148	Carmeuse Eastern Europe	Regional fund investment	26/08/04	33.7	6.6	0.0	6.6	Disbursing
5058	Central & Eastern Europe Power Fund	Regional fund investment	16/12/99	1.6	0.4	0.0	0.4	Repaying
340	Coca-Cola Bihor & Iasi	Direct	06/08/93	20.9	4.2	4.2	0.0	Completed
34012	Constantza Port Development	Direct	21/09/04	23.9	16.0	16.0	0.0	Signed
34711	Cora - Romania	Direct	17/06/04	50.0	40.0	40.0	0.0	Repaying
6504	Dalkia ESCO Romania	Direct	14/12/99	18.1	2.4	0.0	2.4	Disbursing
5222	Danone MPF - Danone SRL	Direct	13/10/98	23.9	7.2	0.0	7.2	Disbursing
2419	Danube Fund	Direct	30/10/96	15.7	3.4	0.0	3.4	Repaying

34888	Distrigaz Sud	Direct	24/06/05	302.0	31.0	0.0	31.0	Signed
27007	Domenia Credit S.A. (mortgage company - debt & equity)	Direct	05/12/03	13.4	5.8	5.0	0.8	Disbursing
35012	EBRD/EIF SME guarantee facility - Raiffeisen Bank Romania	Direct	18/08/04	11.0	3.5	3.5	0.0	Disbursing
25760	EFES - EBI	Regional fund investment	15/04/02	3.1	1.0	1.0	0.0	Completed
4166	EPH Grain Handling Project	Direct	08/01/98	21.8	8.1	8.1	0.0	Repaying
27522	EU/EBRD Extension 3 - Alpha Leasing	Direct	01/07/04	5.0	5.0	5.0	0.0	Disbursing
27155	EU/EBRD Extension 3 - RZB Leasing Romania	Direct	15/01/03	5.0	1.7	1.7	0.0	Disbursing
34476	EU/EBRD Extension 4 - Alpha Bank Romania II	Direct	07/10/03	10.0	10.0	10.0	0.0	Repaying
31151	EU/EBRD Extension 4 - BRD Sogelease	Direct	17/09/03	10.0	10.0	10.0	0.0	Repaying
34594	EU/EBRD Extension 4 - Banca Transilvania Leasing	Direct	08/10/03	5.0	5.0	5.0	0.0	Disbursing
35154	EU/EBRD Extension 5 - BCR Leasing	Direct	15/09/04	10.0	10.0	10.0	0.0	Disbursing
35677	EU/EBRD MFF (Credit Line) - BCR SA	Direct	21/12/04	22.0	20.0	20.0	0.0	Disbursing
13120	EU/EBRD Phase I - Euroventures Danube BV	Regional fund investment	26/02/01	0.2	0.0	0.0	0.0	Disbursing
27067	EU/EBRD Phase I - Ext. - Bank Post Romania	Direct	18/05/02	10.0	10.0	10.0	0.0	Repaying
31209	EU/EBRD Phase I - Global Romania and Bulgaria Growth Fund	Regional fund investment	09/05/03	10.4	3.3	0.0	3.3	Repaying
26081	EU/EBRD Phase II - Banca Transilvaniei II	Direct	21/01/02	4.6	4.6	4.6	0.0	Repaying
22704	EU/EBRD Phase II - Alpha Bank Romania	Direct	20/11/01	10.0	10.0	10.0	0.0	Repaying
14809	EU/EBRD Phase II - Banca Comerciala Romana	Direct	22/01/01	20.0	20.0	20.0	0.0	Repaying
30443	EU/EBRD Phase II - Banca Comerciala Romana II	Direct	09/12/02	20.0	20.0	20.0	0.0	Repaying
7145	EU/EBRD Phase II - Banca Transilvaniei	Direct	17/12/99	5.0	5.0	5.0	0.0	Repaying
27449	EU/EBRD Phase II ext. - Raiffeisen Bank Romania	Direct	20/05/02	15.0	4.5	4.5	0.0	Repaying
27042	EU/EBRD Phase II ext. - Volksbank Romania	Direct	20/05/02	20.0	20.0	20.0	0.0	Repaying
191	Emcom-Siemens	Direct	16/12/93	26.8	7.4	7.4	0.0	Completed
36167	Emerging Europe Convergence Fund II	Regional fund investment	24/08/05	6.0	6.0	0.0	6.0	Disbursing
1992	Energy Conservation and SME credit line	Direct	18/12/96	10.6	7.3	7.3	0.0	Completed
5422	Energy Efficiency and Emissions Reduction Fund	Regional fund investment	22/12/99	10.7	3.0	0.0	3.0	Disbursing
35587	Eurex Alimentare S.R.L.	Direct	06/12/04	18.2	7.4	7.4	0.0	Disbursing
354	Euromerchant Balkan Fund	Regional fund investment	15/12/94	3.6	3.6	0.0	3.6	Disbursing
329	European Roads Rehabilitation Project, Romania	Direct	23/04/93	406.1	66.8	66.8	0.0	Repaying
35120	Europolis II	Regional fund investment	15/11/04	30.0	7.5	5.5	2.0	Disbursing
934	Eurovision - Romanian Television	Direct	26/11/92	0.8	0.8	0.8	0.0	Completed
6354	Fibrex	Direct	30/11/00	55.0	10.0	10.0	0.0	Completed
35767	Global Property Fund	Regional fund investment	29/06/05	50.0	15.0	0.0	15.0	Repaying
27587	Heitman Central Europe Property Partners Fund II	Regional fund investment	09/12/02	7.6	2.3	0.0	2.3	Repaying
4761	IMGB/FECNE	Direct	24/09/98	36.0	5.2	0.0	5.2	Completed
14808	Innova/3	Regional fund investment	23/04/01	37.7	4.5	0.0	4.5	Repaying
5024	Innova/98 LP	Regional fund investment	10/06/98	9.9	2.0	0.0	2.0	Repaying
17210	Interamerican Romania (equity)	Direct	10/06/02	3.4	3.4	0.0	3.4	Disbursing
4921	Ion Tiriac Bank Capital Increase	Direct	20/02/98	2.8	2.8	0.0	2.8	Completed
4560	Italian-Romanian Industrial Development Enterprise	Direct	17/12/98	69.7	25.4	23.2	2.2	Repaying
27928	LNM Holdings B.V.	Direct	18/11/02	83.5	35.1	35.1	0.0	Repaying
1826	Leventis Extension	Direct	05/05/95	18.8	3.6	3.6	0.0	Completed
2148	MBA Loan Project (guarantee)	Regional fund investment	06/03/95	0.7	0.2	0.2	0.0	Repaying
6176	MBA Loan Project II (guarantee)	Regional fund investment	07/12/98	0.1	0.0	0.0	0.0	Completed
18466	MELF Arad	Direct	12/12/01	20.2	4.5	4.5	0.0	Disbursing
33455	MELF Bacau	Direct	26/11/04	52.5	7.0	7.0	0.0	Signed
18595	MELF Brasov	Direct	18/05/02	58.7	14.5	14.5	0.0	Disbursing
15374	MELF Constanta	Direct	18/11/00	102.6	20.0	20.0	0.0	Repaying
16527	MELF Iasi	Direct	12/12/01	55.0	13.2	13.2	0.0	Disbursing
27424	MELF Oradea	Direct	16/03/04	22.7	6.0	6.0	0.0	Disbursing
31650	MELF Sibiu	Direct	27/04/04	37.6	5.0	5.0	0.0	Signed
29852	MELF Targu Mures	Direct	23/10/03	27.9	7.0	7.0	0.0	Signed
33454	MELF Timisoara	Direct	10/12/03	50.6	6.5	6.5	0.0	Disbursing
4730	MPF Lafarge: Romcim	Direct	21/01/98	186.9	69.9	0.0	69.9	Disbursing

19757	Michelin Romania	Direct	27/12/01	67.4	24.9	24.9	0.0	Disbursing
27720	MobiFon Corporate Loan Facility	Direct	27/08/02	252.4	68.7	68.7	0.0	Completed
5132	MobiFon Romania GSM - Phase II	Direct	20/01/99	125.5	6.4	6.4	0.0	Completed
3633	Mobifon - Romania GSM	Direct	22/09/97	332.7	86.4	86.4	0.0	Completed
34609	Mr Ioan Tiriac	Direct	23/09/03	12.2	3.7	3.2	0.5	Completed
400	Municipal Utilities Development Programme	Direct	09/04/95	58.9	23.4	23.4	0.0	Repaying
1869	Municipal Utilities Development Programme - Phase II	Direct	04/08/97	158.6	62.6	62.6	0.0	Repaying
2877	NAR Restructuring and Road Rehabilitation Project	Direct	20/11/96	500.2	71.7	71.7	0.0	Repaying
33354	National Power Transmission Co. "Transelectrica" SA	Direct	20/12/04	33.3	18.2	18.2	0.0	Signed
29124	ORCO APARTHOTELS	Regional fund investment	07/03/03	18.2	2.4	0.5	1.9	Disbursing
5855	PPF - Romanian - ADESGO, S.A.	Direct	10/07/98	7.3	1.2	0.0	1.2	Completed
15917	PPF - Romanian - ARCTIC	Direct	05/10/00	1.1	1.1	0.0	1.1	Completed
16747	PPF - Romanian - Advantage Software Factory	Direct	09/10/00	0.9	0.5	0.0	0.5	Repaying
4907	PPF - Romanian - Continental S.A.	Direct	23/12/97	3.9	2.5	0.0	2.5	Repaying
6192	PPF - Romanian - IRIDE	Direct	17/12/98	8.9	1.5	0.0	1.5	Completed
16969	PPF - Romanian - IRIDE	Direct	07/12/00	0.6	0.6	0.0	0.6	Completed
4587	PPF - Romanian - ISAF	Direct	01/08/97	20.5	0.9	0.0	0.9	Completed
5208	PPF - Romanian - Isaf/Prestar SRL	Direct	25/03/98	3.9	2.1	0.0	2.1	Repaying
7755	PPF - Romanian - PC-NET	Direct	09/09/99	1.2	0.7	0.0	0.7	Completed
17413	PPF - Romanian - PCNET Net Backbone	Direct	21/12/00	1.7	1.7	0.0	1.7	Repaying
12065	PPF - Romanian - REGEV & INSTAL	Direct	21/03/00	1.9	1.4	0.0	1.4	Repaying
14311	PPF - Romanian - REGEV & INSTAL Loan	Direct	05/07/00	1.9	1.4	0.0	1.4	Completed
5031	PPF - Romanian - Regisco	Direct	05/12/97	0.0	0.0	0.0	0.0	Disbursing
6328	PPF - Romanian - Remayer	Direct	26/03/99	7.1	2.2	0.0	2.2	Completed
7754	PPF - Romanian - Sicomed	Direct	20/07/99	14.5	3.8	0.0	3.8	Repaying
4591	Parmalat MPF - Romania	Direct	17/11/98	12.1	2.1	0.0	2.1	Disbursing
322	Petroleum Pilot Modernisation Project, Romania	Direct	14/09/92	30.8	22.8	22.8	0.0	Completed
34551	Polish Enterprise Fund V	Regional fund investment	30/01/04	4.7	4.7	0.0	4.7	Repaying
18514	Power Sector Op. Efficiency Improvement - Termoelectrica	Direct	10/11/95	30.7	30.7	30.7	0.0	Repaying
20619	Power Sector Op. Efficiency Improvement - Transelectrica	Direct	10/11/95	67.5	26.8	26.8	0.0	Repaying
2038	Power Sector Operational Efficiency Improvement Project	Direct	10/11/95	120.3	57.2	57.2	0.0	Completed
5919	Privatisation of Romanian Development Bank (equity)	Direct	24/11/99	187.5	20.5	0.0	20.5	Disbursing
35689	ProCredit Bank Romania	Direct	22/05/05	12.4	3.1	3.1	0.0	Disbursing
2455	Prompt SA	Direct	19/06/96	9.9	3.1	0.0	3.1	Completed
33058	Raiffeisen International	Regional fund investment	20/10/04	30.0	15.0	0.0	15.0	Repaying
1838	Railway Rehabilitation	Direct	23/07/96	419.2	57.3	57.3	0.0	Repaying
17767	Regional Europolis Portfolio	Regional fund investment	14/12/01	75.0	26.3	10.9	15.3	Repaying
28884	Regional Operating Company (“ROC”) Apa Somes (SAMTID)	Direct	22/07/05	39.0	7.2	7.2	0.0	Signed
19336	Regional TFP: Banca Transilvania	Direct	22/05/01	0.8	0.8	0.8	0.0	Signed
2833	Regional Water and Environment Programme	Direct	05/08/96	40.3	13.4	13.4	0.0	Repaying
9144	Regional/Private Equity Fund Facility - Trigranit	Regional fund investment	07/12/99	7.6	1.4	0.0	1.4	Completed
32431	Regional/Private Equity Fund FacilityTerapia SA	Direct	05/08/03	39.1	4.4	0.0	4.4	Disbursing
115	Rom Telecom	Direct	27/02/92	549.2	142.0	142.0	0.0	Repaying
1980	RomTelecom Transition Project	Direct	06/01/98	549.2	83.5	83.5	0.0	Completed
4729	Romania National Power Grid Company (NPGC)	Direct	08/12/00	171.4	43.0	43.0	0.0	Repaying
13119	Romania: Road Sector Restructuring and Pitesti By-Pass	Direct	31/12/01	114.1	60.0	60.0	0.0	Disbursing
109	Romanian Development Bank Project	Direct	19/04/94	6.4	6.4	6.4	0.0	Completed
2109	Romanian Development Bank Project (credit line)	Direct	19/04/94	37.8	37.8	37.8	0.0	Repaying
27888	Romanian Industrial Energy Efficiency Fund	Direct	13/05/03	7.5	7.0	7.0	0.0	Disbursing
1677	Rompak S.R.L	Direct	17/01/96	25.5	6.3	6.3	0.0	Completed
34974	S.C. MDF Sebes Frati S.A.	Direct	24/06/04	185.0	36.3	36.3	0.0	Disbursing
35386	S.C. Sepal S.A.	Direct	24/06/04	65.0	33.7	33.7	0.0	Disbursing
34915	SNP Petrom Equity Privatisation	Direct	14/12/04	55.1	55.1	0.0	55.1	Disbursing
4410	SNP Petrom Pre Privatisation Loan	Direct	01/08/02	93.7	61.0	61.0	0.0	Completed
35665	Sibiu Urban Transport Pre-accession Project	Direct	30/06/05	17.8	15.0	15.0	0.0	Signed
3645	Sical	Direct	05/11/99	57.0	6.0	6.0	0.0	Repaying

16382	Sidex	Direct	30/10/01	133.6	83.5	83.5	0.0	Completed
35263	Soufflet Malt Romania SRL	Direct	18/06/04	7.0	3.5	3.5	0.0	Disbursing
13828	TBIH Financial Services Group N.V. (debt & equity)	Regional fund investment	04/12/00	4.7	2.6	0.4	2.3	Completed
35879	TIW Inc.	Regional fund investment	12/01/05	18.0	18.0	0.0	18.0	Disbursing
33637	TUI advance payments	Regional fund investment	19/12/03	0.8	0.8	0.8	0.0	Completed
2969	Thermal Energy Conservation Project (TECP)	Direct	13/04/97	73.7	37.2	37.2	0.0	Repaying
666	Tiriac Bank (equity)	Direct	09/04/93	7.0	7.0	0.0	7.0	Completed
1767	Tiriac Bank, Stand by Loan	Direct	27/07/95	16.7	16.7	16.7	0.0	Completed
34795	Towers- Phased Project, Bucharest	Direct	15/07/04	33.9	11.9	11.9	0.0	Disbursing
33187	TriGranit III	Regional fund investment	01/06/04	5.7	1.3	0.0	1.3	Repaying
17414	US/EBRD SME - Banca Romaneasca	Direct	22/05/03	4.2	3.3	3.3	0.0	Disbursing
11484	US/EBRD SME - ProCredit Bank Romania	Direct	11/04/02	10.6	2.3	0.0	2.3	Disbursing
31968	US/EBRD SME - ProCredit Bank Romania	Direct	03/04/03	2.2	0.7	0.0	0.7	Disbursing
34785	US/EBRD SME - ProCredit Bank Romania	Direct	15/10/03	7.4	4.9	4.9	0.0	Disbursing
2765	United Romanian Breweries SRL	Direct	08/10/96	50.3	8.6	8.6	0.0	Completed
10972	Victoria Office Building	Direct	28/12/00	22.8	5.4	5.4	0.0	Completed
333	Virolite	Direct	03/12/93	24.5	6.2	5.6	0.5	Completed
22908	Virolite - Write Off	Direct	03/12/93	6.8	6.8	3.6	3.2	Completed
3722	Virolite S.A. Extension	Direct	28/04/97	1.7	1.7	1.7	0.0	Completed
31469	Wienerberger - First Brick Factory	Direct	06/10/03	18.0	2.0	2.0	0.0	Disbursing
34825	Wienerberger Romania II	Direct	20/12/04	8.6	5.6	5.6	0.0	Disbursing
ROMANIA TOTAL				**8,625.9**	**2,803.4**	**2,296.8**	**506.6**	

ANNEX 5B - NET CUMULATIVE BUSINESS VOLUME SUMMARY

(as of 31 October 2005, € millions)

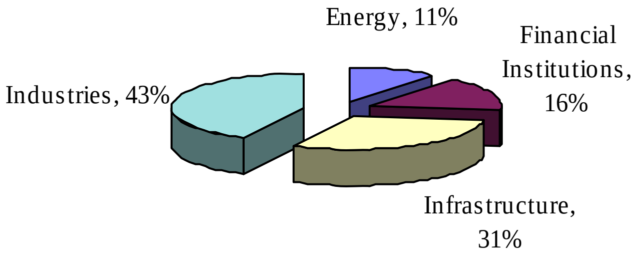
Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Energy Efficiency	0.8	36	12	7	5	0%
	Natural Resources	3.0	180	139	84	55	5%
	Power and Energy	6.1	727	207	176	31	7%
Sub-total Energy		**9.9**	**943**	**359**	**267**	**92**	**13%**
Financial Institutions	Bank Equity	12.6	516	183	28	156	7%
	Bank Lending	13.7	441	399	399	0	14%
	Equity Funds	4.0	293	77	0	77	3%
	Non Bank Financial Institutions	2.4	62	45	37	8	2%
	Small Business Finance	1.1	37	14	11	3	1%
Sub-total Financial Institutions		**33.8**	**1,348**	**718**	**475**	**244**	**26%**
Infrastructure	Municipal & Env Inf	12.4	1,088	377	377	0	13%
	Transport	7.0	1,578	340	340	0	12%
Sub-total Infrastructure		**19.4**	**2,666**	**717**	**717**	**0**	**26%**
Industries	Agribusiness	8.6	347	121	111	9	4%
	Property and Tourism	5.1	372	111	70	41	4%
	Telecoms Informatics & Media	7.9	1,895	420	401	19	15%
	General Industry	13.0	1,055	357	256	101	13%
Sub-total Industries		**34.6**	**3,669**	**1,010**	**838**	**171**	**36%**
ROMANIA TOTAL		**97.6**	**8,626**	**2,803**	**2,297**	**507**	**100%**

ANNEX 5C - ACTIVE EBRD PROJECT PIPELINE STOCK

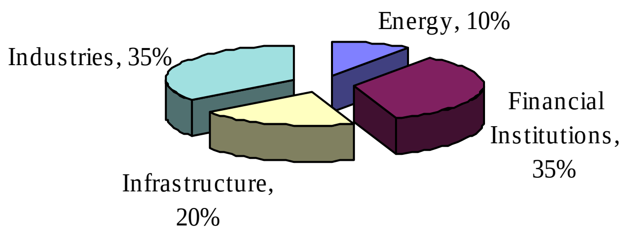
(as of 31 October 2005, € millions)

	Concept Clearance & Structure Review Stock	Final Review Stock	Board Approval Stock	Pipeline Stock	Number of Operations*
ROMANIA	**188.0**	**240.5**	**102.7**	**531.2**	**24.2**
Energy Efficiency	0.0	0.0	4.0	4.0	0.5
Natural Resources	0.0	0.0	0.0	0.0	0.0
Power and Energy	0.0	0.0	0.0	0.0	0.0
Energy	**0.0**	**0.0**	**4.0**	**4.0**	**0.5**
Non Bank Financial Institutions	0.0	0.0	5.5	5.5	0.4
Equity Funds	0.0	0.0	4.3	4.3	0.2
Bank Equity	0.0	0.0	0.0	0.0	0.0
Bank Lending	0.0	50.0	0.0	50.0	1.0
Small Business Finance	0.0	0.0	0.0	0.0	0.0
Financial Institutions	**0.0**	**50.0**	**9.8**	**59.8**	**1.6**
Municipal & Env Inf	18.0	23.0	46.3	87.3	8.9
Transport	0.0	167.5	0.0	167.5	2.0
Infrastructure	**18.0**	**190.5**	**46.3**	**254.8**	**10.9**
Agribusiness	100.0	0.0	29.0	129.0	4.0
Property and Tourism	0.0	0.0	0.0	0.0	0.0
Telecoms Informatics & Media	0.0	0.0	0.0	0.0	0.0
General Industry	70.0	0.0	13.6	83.6	7.2
Industries	**170.0**	**0.0**	**42.6**	**212.6**	**11.2**
DEBT	188.0	240.5	82.9	511.4	22.8
EQUITY	0.0	0.0	19.8	19.8	1.4
PRIVATE	170.0	50.0	99.4	319.4	14.2
STATE	18.0	190.5	3.3	211.8	10.0
Non-Sovereign	188.0	73.0	102.7	363.7	22.2
Sovereign	0.0	167.5	0.0	167.5	2.0

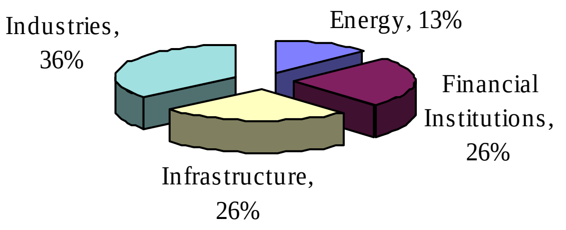
Net Cumulative Business Volume
Total Project Value
(as of 31 October 2005)

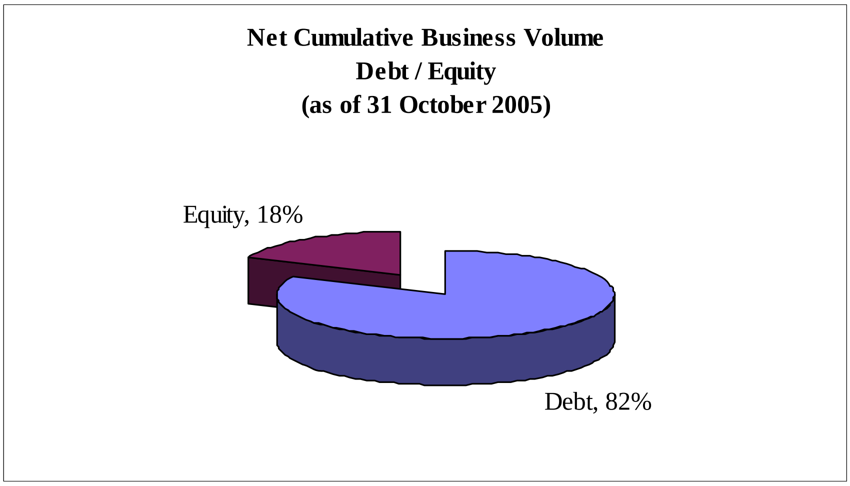


Net Cumulative Business Volume
No of Projects
(as of 31 October 2005)



Net Cumulative Business Volume
EBRD Finance
(as of 31 October 2005)




Net Cumulative Business Volume
Debt / Equity
(as of 31 October 2005)
Equity, 18%
Debt, 82%

ANNEX 6 - BILATERAL ASSISTANCE (TC) AND BILATERAL DONOR SUPPORT

1. *Aggregate TC Funds Commitment and Official co-financing signed projects;*

- Since 1992, the Bank has been actively cooperating with multi and bilateral donors in the framework of both TC projects (for which the aggregate commitments value for the period 1992 - 07/2005 reached the value of € 39.2 million) and Official co-financing initiatives (€ 1.4 billion is the total amount of the EBRD signed projects at the end of July 2005).

- TC Fund: five Donors (EU € 22.9 million, the Netherlands € 4.6 million, USA € 3.7 million, Japan € 2.0 million and Switzerland € 1.7 million) account for 85 per cent of the total aggregate commitments. Five are the sectors having more benefited from the EBRD TC Fund: Finance & Business (€ 17.5 million), Transport (€ 6.5 million), Energy (€ 4.8 million) and Local Authority Services (€ 4.7 million).

- Official Co-financing: Four are the largest official co-financers that, with a total contribution of € 1.1 billion, are covering the 80 per cent of the total. The EC (with its ISPA Programme) is the largest co-financier with € 528.1 million followed by the EIB (€ 293.9 million), the World Bank (€ 197.9 million) and the IFC (€ 119.0 million).

TC FUNDS and Donors
Aggregate Commitments (1992-2005): € 39.2 million

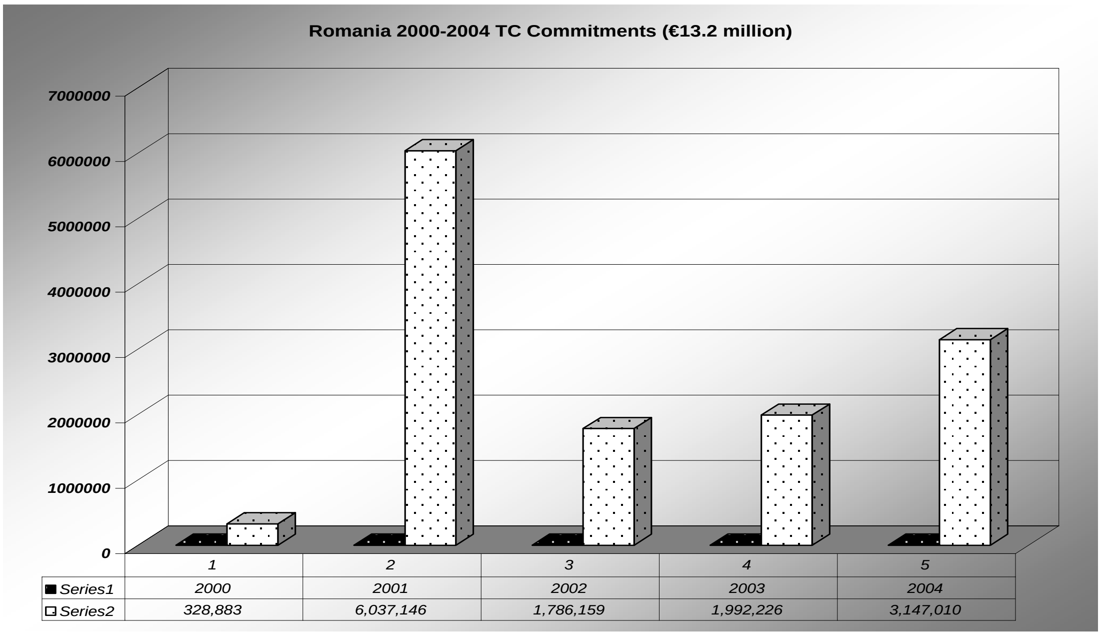
DONOR	Million € Committed
European Commission	22.9
The Netherlands	4.6
USA	3.7
Japan	2.0
Switzerland	1.7
UK	0.6
Italy	0.6
Taiwan	0.6
Germany	0.4
Luxembourg	0.3
Other	1.8

Official Co-financing and Donors
EBRD Signed projects - Signing years: 1992-2005 -€ 1,413 billion

DONOR	Million € Committed
European Commission	528.1
European Investment Bank	293.9
World Bank	197.9
IFC	119.0
Germany	50.3
The Netherlands	38.2
Others	186.5

Future scenario

Over the period 2000-2004 there has been a confirmation of a trend showing an increased interest by donors for funding initiatives in Romania.



For the period 2005 – 2006 it should be possible to achieve a yearly commitment from bilateral Donors bigger than € 2/2.5 million.

The EC should remain the larger donor and, after having approved the AP 2004 in December 2004 (€400 million), the EC delegation is now in the process of preparing the AP 2005. The EC PHARE, ISPA and SAPRD Programmes will be made available to Romania until December 2006. The allocation for the three Programmes for the period 2004-2006 are as follows:

PHARE: €1,539 million
ISPA: €1,026 million
SAPARD: €513 million

After this period, Romania should benefit from the new "Instrument for Pre-Accession" and, after having obtained the EU membership, from the EU Structural and Cohesion Funds.

The Netherlands, Switzerland, Italy, Luxembourg and UK should remains interested in the Country. In 2005, Italy and Luxembourg approved the funding of one assignment in Sibiu and one in Arad. The two assignments (€600,000) have not been committed yet, but funding has been confirmed.

ANNEX 7 - TURNAROUND MANAGEMENT AND BUSINESS ADVISORY SERVICES PROGRAMMES IN ROMANIA

Overview of Activities in Romania

To date, TAM has undertaken 92 projects in Romania, utilising approximately € 5.9 million of Donor funding. This includes major contributions from the **EU Phare Programme,** with additional support from the **UK, Japanese** and other Governments.

TAM enterprises are selected for assistance on the basis of the importance of their problems, not only to the enterprises themselves, but also to the social well-being of inhabitants of given regions.

A feasibility study of the Romanian market has shown an urgent need for advisory services conforming to the real and immediate needs of local enterprises to overcome short term practical business problems that prevent growth. Even though the initial market for BAS will probably be limited by problems of availability of finance from the enterprises, and the type of projects will probably be relatively concentrated around questions of raising finance than utilising the more general and essential management and business consultancy, BAS can develop both the consultancy sector and the ability of companies to use their expertise productively.

The broad focus of the Romanian Programme would be on enterprises with 10 - 100 employees, located outside the capital city.

Donors have expressed strong interest in financing a BAS Programme in Romania, and negotiations are at an advanced stage.

Compared with other business consultancy programmes in Romania, BAS would offer entrepreneurs clear application requirements, and prompt procedures for the assessment of application forms.

Evaluation and Results

TAM/BAS define the success of their projects by measuring the sales growth, productivity and employment of the companies they have assisted.

The BAS approach has been recognised by entrepreneurs in 15 other countries as highly effective in prioritising competing development needs (quality management systems, market research, introduction of new software, etc.). With the assistance of BAS Programme staff, entrepreneurs select the most qualified among a number of competent consultants to ensure best value-for- money execution of the service. An additional benefit of the familiarity with the circumstances of numerous local companies is the ability to direct them to other Programmes or resource centres. BAS clients benefit through the Programme's knowledge resources even after the completion of their particular projects as they turn for general advice to BAS personnel.

The TAM Programme has proven transition impact and maintains a high success rating of 80 per cent across all of its countries of operation, including 88 per cent in Romania, based on independent evaluations of the results, such as improved management skills, increased productivity and better marketing.

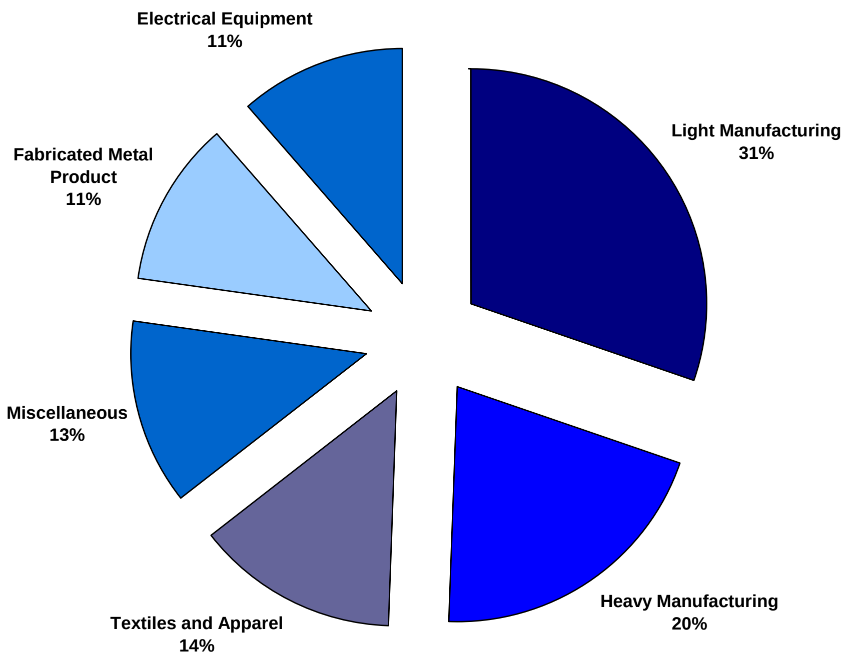
In Romania, TAM has assisted in excess of 110,000 workers in enterprises with an aggregate turnover of € 1.4 billion.

TAM interventions in Romania, where data is available, have lead to an average increase in productivity of 47 per cent across the country, and an average increase in sales of 25 per cent.

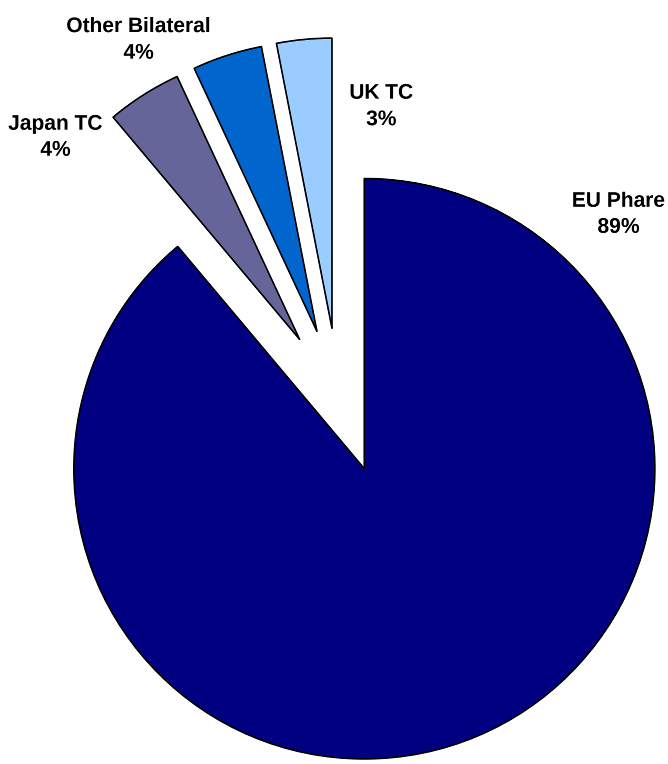
EBRD Investment and external financing for enterprises

In Romania, € 29.6m of EBRD and EBRD-related intermediaries' investments were attracted by 3 TAM enterprises: IMGB SA (€ 5.2m, 1998); Terapia SA (€ 4.4m, 2003) and Stirom SA (€ 20m, 2005).

TAM Activities in Romania by Industry Sector (92 Projects)



TAM Activities in Romania by Funding Source (92 Projects)



ANNEX 8 - LESSONS LEARNED: SUMMARY OF BANK REVIEWS

ISPAT SIDEX PHASE I AND II (ROMANIA) OPER 2003

Lessons:

Dedication and experience are keys to the success of turning around complex manufacturing situations. The Sponsor group had proven elsewhere in the world, among others in one of the Bank's projects, its ability to undertake the challenge to turn around large steel conglomerates. As stakeholders through equity and loan support, the Sponsor brings to the project more dedication than would be expected from management contractors. In the selection process, this gave him a definite edge over longer established but less committed Western sponsors.

The purpose of de-barterisation is to enhance liquidity and stimulate probity. The Bank can play a useful role in providing adequate liquidity. The experience and skills of the Sponsor are an additional requirement to make the process successful and restore transparency and integrity. In this particular case, the Bank could rely on the sponsor's in-depth knowledge of a prior similar experience with another Bank's financed project. Such an additional comfort is of critical importance to mitigate the risk of a project failure in this area.

Formalize investments under EAP early on during project preparation. While privatization agreements may provide "honeymoon periods" with respect to full compliance with environmental laws, once the honeymoon is over, the project will have to fund significant upgrades and/or reach a new agreement with the Government. It is important to define longer term EAPs early in the process.

Importance to promote training access and to monitor OHS risks. Occupational health and safety is a vulnerability issue for our project sponsors and for EBRD. Therefore it is essential for EBRD to consider enhancing its internal capacity to promote training access and monitor OHS risks. This could be accomplished by ED in using the services of an OHS consultant to work with staff and project sponsors to reduce OHS risks and thereby reduce the Bank's vulnerability in this issue (conceivably a trust fund proposition).

MOBIFON S.A. (ROMANIA) OPER 2003

Lessons:

Efficient project finance structuring is a key success factor even with large international sponsors. Developing a strong self-contained project finance structure is essential especially in cyclical industries where the support from the main sponsor may change over time. Covenants restricting distribution during the crucial build-up phase are particularly useful especially in times where sponsors may not wish to inject new money due the difficulties they may experience in their key markets. This has proven a useful tool especially in telecoms sector transactions.

Management focus on training and promoting local managers is a key ingredient of a highly successful operation. Training and promoting local managers from the outset can enhance the success of a company and create a highly motivated and creative working environment. This will also contribute to an excellent company image in the local market. This can be further enhanced by encouraging senior managers to take on active local community engagements in various fields.

The Bank should monitor closely the developments regarding UMTS in the various mobile telephony companies in its countries of operations and maintain a dialogue on the viability of these services. In countries where voice is the predominant service, the business plan for UMTS and its viability will be dramatically different from the experience of newly launched services in Western Europe. An active dialogue of the Bank may assist in the sharing of relevant information regarding the viability of these services in low transition countries.

THE DANUBE HOLDING LIMITED (ROMANIA AND MOLDOVA) XMRA 2003

Lessons:

Investment funds are an expensive way to provide equity finance to SMEs. The under-funded SME funds still seem expensive, as highlighted by the PED Special Study MTR of Equity Funds 2002. This apparent paradox can be traced to the fundamental goal conflicts with high transaction costs, sub-optimal scale and, more fundamentally, to the difficulties in achieving timely exits for small stakes.

Fund manager expertise and fund investment objectives. Funds that have investment policies that match the manager's expertise and the fund's prime objective are more likely to succeed than ones that, for example, pursue industrial investments and real estate development at the same time through the same fund. This is especially true of SME funds that should avoid speculative real estate development.

Avoiding the perception of conflict of interest in EBRD investment funds. The Bank should not allow investment funds, in which it holds a stake, to invest in sub-projects in which the EBRD is an equity investor. This is to avoid the appearance of conflict of interest, that the fund may be making the investment at the behest of the EBRD to meet the priorities of EBRD at the potential expense of the fund and its other shareholders. The EBRD, as a major potential source of new mandates for fund managers and new capital for funds, can too easily influence the direction of investment by such funds to be able to overcome the appearance of conflict of interest in any other way.