



Annual Report

Political clientelism

- In fund allocations to local governments (interactive map)
- In draining resources from public companies



Bonus: economic forecast

February 2013



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Forecast 2013

Muddling through the crisis

The government's mistakes in 2012 and the current priorities

Will the exploration for shale gas be approved?

What should we do with the Property Fund?

Do you remember the times in 2008 when we all were asking if this global economic crisis will take the shape of a "V" or of a "W"? And if the crisis would last for more than one or two years? The times went by and, and, at least on the continent, it seems that the best scenario we can hope for is a certain lag and a slow evolution of hardships, so as the European Union and the unique currency will not be dismantled.

Today even a triple "V" would not be appear the worst case, since we have just learned that EU economy dropped by 0,5% in the fourth semester of 2012, due to the economic problems of Germany's growth engine. The bright side is that for the moment fears of a Greek exit or the collapse of a southern state are now defused.

In Romania estimations on economic indicators kept scaling down until they reached a worrying percent of 0,2, officially announced last week. In fact, it is not only a matter of appropriate internal decisions in order to have a significant and

stable growth but also we are depending on our main partners in EU. The opposite thesis does not hold, namely if they leave the crisis behind and we will keep doing unreasonable things, then we will be alone in prolonged stress. The next table summarises the prognosis made for EFOR by a panel of experts and practitioners in economy. Over.

	Average	Min-max
GDP growth in 2013, %	1,55	1-2
Inflation rate	4,0	3-5
Exchange rate Ron/Eur at 31 December 2013	4,45	4,1-4,8
Budgetary deficit at 31 December 2013, % of GDP	2,35	1,5-3
Current account deficit at 31 December 2013, %	4,5	3,5-6,5
Unemployment rate in December 2013	6,8	5,3-8
Real estate market, average prices, Dec 2013 against Dec 2012	-3	(-25)-5

EFOR forecast by a panel of 14 experts

What can be noticed, as we stated earlier, is that we can not expect **an economic growth** for 2013, the prognosis advanced being grouped between small intervals, thus inviting rather to caution instead of unabridged enthusiasm. **The inflation rate** will hassle again the central bank and, most probably, it will outnumber the level required by Maastricht criteria. Adopting euro currency may seem today as more unattainable than some time ago, when we were trying to forecast the horizons of the years 2015-2016.

For the **exchange rate RON/Eur** we gathered only unreliable data, as a result of both economic uncertainty and unpredictable new govern intentions, such as the decision to continue along the line agreed with IMF for the present political cycle. But it should be mentioned that the average calculated is not entirely different from the current rate of exchange rate.

On the other hand, **both budgetary and commercial deficits** are within reasonable limits as compared to the circumstances from the beginning of the crisis period. **The unemployment rate** remains fortunately low, beneath the European average and far from the astonishing high unemployment in some southern European states. But we should keep into consideration the quantifying difficulties which are known in a country with low levels of

participation rate and lasting under-employment such as ours.

Finally, our expert panel does not allow the prediction that **the real estate market** would recover; quite on the contrary, most of them are forecasting a continuous descent curve of prices. It seems that in 2013 we will have again a market of buyers, not of sellers.

As we did in the previous reports in the past, we included in questionnaire a few open questions on topics which we deemed important. Here are the comments of our experts.

1. What is the most urgent measure the government should implement at the beginning of this year?

There are three significant directions which can be used to cluster experts' answers. First of all, it is required a realist budget, founded on a predictable fiscal policy, which may ensure the stability of business. Depending on their position in the market, some analysts still agree on a CAS break.

Also there should be some reforming of the tax system, which depleted its potential by the fact that it never succeeded to produce more than 33% of GDP, no matter the colour of the government and the selected strategy.

A second direction lies in the restructuring and/or privatisation of state owned companies, including listing them on the stock market, a lingering issue. Also the process of private management, already announced but delayed, should restart at top speed.

Finally, a third direction concerns the UE funds and the objective to increase rates of absorption and the necessity to set up an integrated plan of public investments. One of the experts invited to our panel proposes explicitly "a system of operative monitoring by means of reports sent to government by local authorities, under their signatures, with complete information on the physical and financial progress of the ongoing project of investments from all the sources of financing: budget, EU funds, BERD, BEI".

2. What was the biggest mistake on economic policies during the office of Victor Ponta's government in 2012?

The government is criticised more on grounds of lacking a clear activity in policies, especially in connection with huge expectations created earlier for mass public and business. Failed privatisations processes, such as Oltechim, or the insolvency of Hidroelectrica are the legacies of previous government, in fact being reform measures imposed by IMF within the Agreement.

Practically, any of the substantial reforms has been postponed after the elections, and even so there is little evidence that the measures are on the official agenda today (on Romanian Post Office or Railway Freight Carrier CFR). Instead, in the summer of 2012 potential foreign investors received a cold shower in the form of "the attack on rule of law: it was an error to frighten the foreign capital, already difficult to attract during times of crisis, due to internal games of power".

It is perceived as a considerable menace the fact that in 2012 the cycle of increasing wages in the public sector and pensions was reloaded, at the expense of cutting down investments.

3. Should the Ron have devalued more over the last months or the policy pursued by the central bank was correct? How do you interpret this conflict of public views from the beginning of the year between the National Bank's governor and member of the Fiscal Committee (Mr.Danila)?

Generally the analysts think that it would have been advisable a more pronounced devaluation of the Ron, as predictability of the exchange is the most important temporary advantage of devaluation, even for exporters. Domestic markets are increasingly important due to the "fatigue" of main commercial

partners from EU. A marked devaluation would have weakened internal consumption and bank system.

There is although disagreements on the meaning of Danila's statement: on one side are those who appreciate it as benign, rather romanced, lacking potential of conflict with governor Isarescu. More probably such declarations reveal the need to make transparent the distribution of votes within decisions on fiscal policies.

On the other side, some experts think that this declaration is neither benign, nor coincidental, but evidence for the fact that Mr. Danila began his campaign for the governor office, in case that Mr. Isarescu steps down and political support is at hand. Some of them think that this might signal even a warning fire to announce a possible campaign anti-Isarescu, in case that the latter shows any intention to run for presidency in 2014.

Some of our experts frame this mini-dispute between Isarescu and Danila as a mirror of the larger controversy within the OECD states concerning the role of central banks: should one choose a narrow, orthodox programme of targeting inflation and preventing vicissitudes of the Greece's path? Or, instead, one should choose a larger programme with multiple tasks, as partner of government to foster development (Danila)? The proponents of the latter criticise National Romanian

Bank for a narrow focussing on the stability of the exchange rate and unrealistic deadlines to adopt the Euro currency, which in turn lead to the tacit eurozation of the Romanian economy.

4. Will Victor Ponta's cabinet approve the Rosia Montana project and the drilling for shale gas?

Weather or not they are personally in favor of the projects (most of them), our panellists anticipated that both of them will receive the green light: 13 of 14 experts believe that Ponta's government will make a U turn and accept both the investment at Rosia Montana and the prospecting the possible reserves of shale gas which Romania might have.

5. What solution would be preferred to tackle the problem of property restitution of nationalized buildings to owners, a lingering issue from last year in parliament to be addressed only in May 2013?

This huge and neglected problem of Romania's GDP will not benefit of a quick decision, nor elegant. Most of the interviewed say that the financial compensations will be a prolonged, multi-phased process, no matter what the measure taken. Furthermore, it is possible to apply a compensation cap or an agreement "haircut" style.

Some panellists say that any solution agreed will be subject to judicial attack in courts, due to past precedents and secondly, that it is not fair to take out of the budget obligations endorsed in the legal system, which amount up to 5-15 billion euro. A secondary market of bonds would resolve in a natural way also the objective of phasing of debts. On long term, and also the penalty for early liquidity excess, for this market would apply a sale discount in the first years.

It is interesting to note that a panellist feels necessary an extra-charge on the compensations derived from ceded court cases, with rates between 16-80%, "the Constanda case being a telling example for the resulting chaos, prolonged and tolerated by all the stakeholders", as a panellist say.

EFOR thanks to all analysts who helped us with prognosis and comments for this material: Lucian Albu, director of Institute of Economic Prognosis; Radu Craciun, deputy general manager Eureko; Aurelian Dochia, economic analyst; Marius Ghenea, entrepreneur; Moise Guran, economic journalist, TVR; Lidia Moise, economic analyst, TVR; Anca Paliu, IMF Bureau; Razvan Pasol & Andreea Gheorghe, Intercapital; Catalin Pauna, chief-economist, World Bank Mission; Cristian Pirvan, general secretary? Of AOAR; Dragos Pislaru, GEA Consult; Ionut Popescu, economic analyst; Dan Suciu, journalist, Money Channel.

Clientelism in Romania

Corruption should be measured objectively and fought at the UE level, as a major risk for good governance

The map of investment funds allocation for Romanian local authorities, 2004-2011

How and how much is it being wasted out of public companies

We are about to engage all in a major political effort to amend the constitution of Romania, including the administrative-territorial organization, but we lack a clear diagnosis of the problems we strive to solve and a demonstration that the proposed changes are to solve these issues. In other words, we dispose of a bunch of answers and now we are searching the questions to match them.

In fact the functioning of the Romania state will be changed neither by the new constitution or by regionalization, nor by a new transformation of the electoral system. The problems of Romanian system are located in other areas and first of all one should see their causes and origins and not seek short term palliatives, which are a waste of time and political energy.

Corruption should be fought not only by means of repressive mechanism of justice, the prevalent strategy all these years, but also by means of preventive public policies, which

may close all the channels of corruption from the beginning, and a more transparent account of public budgets.

If we have a problem of political clientele in local administration, an issue more visible during electoral campaigns, this will not be diminished with the creation of new administrative tier, namely the region. On the contrary, local authorities, especially in the rural area, will remain bankrupt and will be dependent on the crony allocations, regardless of many tiers of local barons and voievods will be arranged to filter the funds. As long as the crux of the problem is clientelism, we should proceed to discuss this topic and avoid debating administrative changes only in name and less substantial.

How could we measure objectively corruption, that is, without appeal to opinion polls, in order to set up the conditions to entrench it and to evaluate objectively the progress of reform strategies? It is highly important if we could escape the

common subjective criteria by drafting some indicators, even if partial, imperfect, which would measure the phenomenon back to its origins, and not indirectly, via opinions of the public. This is particularly relevant when the topic is not the petty corruption, namely small presents in offices and desks, but generalized clientelism, continued through public policies, known as “the capture of the state by interests groups”.

This is an essential theme not only for Romania and Bulgaria, where the mechanism of cooperation and verification is present to some extent, but also to all the member states of EU. This kind of mechanism should enter the reformist agenda of EU, namely there should be created mechanism of monitoring at the European level for each member state, as well as for the candidate states. This will give impetus not only to new tools of assessment and promoting good governance, but it would appease the tensions between North and South in respect of quality of government: “the Northern citizens” will become more relaxed knowing that mechanisms of monitoring and early warning are in place for the potential of clientelistic derailment from the South, with a possible consequence of limiting the turnouts for anti-system and anti-

European parties from countries which are net contributors to the EU budget.

With the aim to test experimentally this idea, EFOR manages ongoing projects of comparative measuring of political clientelism in Romania and some other states from the region (Croatia, Serbia, Moldavia) using as main variable a proxy indicator. Our hypothesis is that, at least for the Romanian case, there are two dimensions of clientelism which make up the bulk of

The agenda of measuring and fighting bad governance using objective indicators should be in force at EU level; MCV like mechanisms, based on such indicators, should exist also in Greece or Italy, not only in Romania and Bulgaria.

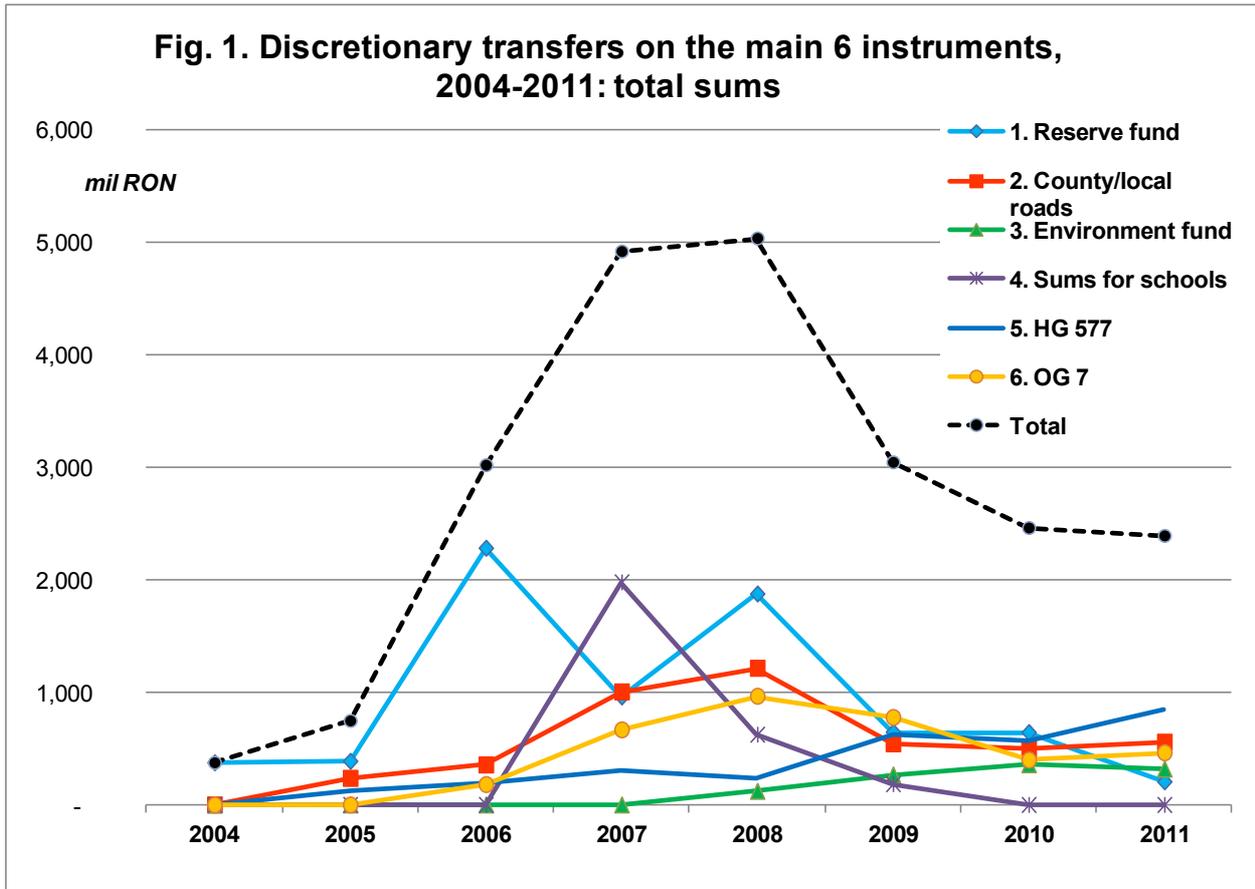
institutionalized corruption, considering the resources drained: (a) discretionary allocation of funds, resulting in a political clientele of local administration; (b) money draining

through SOEs.

Next sections reveal the conclusions of our pilot project for the Romanian case.

A. MEASURING CLIENTELISM IN THE FUNDING OF LOCAL AUTHORITIES

One of the best indicators to measure the discretionary tendency in Romanian public policies, especially when budgetary transfers are in focus, is the allocation of **national funds for investment projects allocated to local authorities**. We analyzed the six main instruments by which state



budget funds were transferred in the period 2004-2011¹. These are:

1) The Reserve Fund of

Government (2004-2011): the sums included here are used to different purposes, from small investments to expenditure for current bills, not only to remedy unforeseen circumstances, as one may guess.

2) Sums for county and local roads (2005-2011), most of them used at county level Councils.

3) The environment fund (2008-2011), which is administered by the

¹ When data will be available, we will include also the analysis for the year

Environment Ministry, a source used to finance projects on water-sewage systems or establishing green areas

4) Funds for schools (2007-2010), distributed by the Education Ministry in the period of maximum enthusiasm, allocated by appeal of flexible and baffling rules²: new investments, rehabilitation but also covering different bills delayed.

5) Funds allocated using Government Decision 577 / 1997 (2004-2011) allocated for water systems in rural areas and

² For a while it is not clear if the management of new investments (namely the procurements) is assigned to the school, the local council or the Inspectorate of Education.?

communal roads, managed by the MLPAT under its successive labelling (The Ministry of Public Works, Development and so on)

6) **Funds allocated on the basis of Government Ordinance 7 / 2006** (2007-2011), for small bridges, sewage, sports facilities in the rural area. This fund was created in 2006 as an emergency answer to the floods of that time but it became a persistent and more flexible tool, being subordinated to the opaque and implausible authority of General Secretariat of the Government.

These funds exceeded in 2008, the peak year of allocations, the total of **5 bn RON** (1.36 bn Eur at the corresponding exchange rate): see Figure 1. These sums made up **almost 70% of the investments at the local level**, that is, the bulk of it; the remaining funds were mostly funds from EU. But unlike the latter, where some selection criteria are in order and an outside agency of monitoring (the Commission), these six instruments are 100% discretionary and distributed nationally, in a pattern which allows the government and the ministries to transfer sums on the budget annexes without any clear justification or a project competition based process. In other words, **it is the best terrain to chart the map of pure political clientelism.**

Two methodological premises are to be stressed here:

- Despite anecdotal evidence, a complete data-based analysis on the European funded projects of investments is far less relevant due to the existing filters. Besides, the sums from EU funds are below the resources from national origins, though we are always discussing the EU funding and seldom the domestic allocation of resources.
- It is important not to mistake the six instruments of transfers analyzed for (i) own revenues of local administration; these sums are not involved in the network of clientelism, being collected and used at the local level; (ii) others types of transfers or quotas from taxes from which benefits the city council or the county council as a result of a financing formula or current expenditures / operational costs; here it is possible to find political distortions but on a smaller scale than the investment funds analyzed herein, because it is quite difficult to avoid paying mandatory social benefits or to skip financing the current expenditures.

The above list of six instruments of allocation makes it clear that there are overcrossing competences, fragmented administration and sector coordination is markedly missing. For example, rural roads are funded from four of the above financial tools, putting aside the ex-SAPARD fund from European sources, the present PDR (The

Ministry of Agriculture). The landscape seems to be the result of a hidden battlefield of central institutions to gain control on budgets, procurements, and leverage in local networks – and it is a realistic picture.

All governments up to present used the mechanisms of fund allocation towards territory authorities with political purposes, favouring same political colour administrations, but some of them extended the discretionary behaviour well beyond others.

The Reserve Fund (instrument 1) is riddled with myths and public scandals of arbitrary allocations. It has been argued that partisan distribution was made to the advantage of particular groups; it has been declared that the former government was excessively clientelistic and the present one is just taking compensatory measures to balance past injustice; also it has been asserted that the county barons from opposition are abusing the mayors of the coalition rule and so on. Unfortunately, the Reserve Fund, although it retained most of the public opinion concern, it is just one of the arbitrary tools used by central power. The other ones were neglected, partly due to the absence of data and figures, still difficult to access.

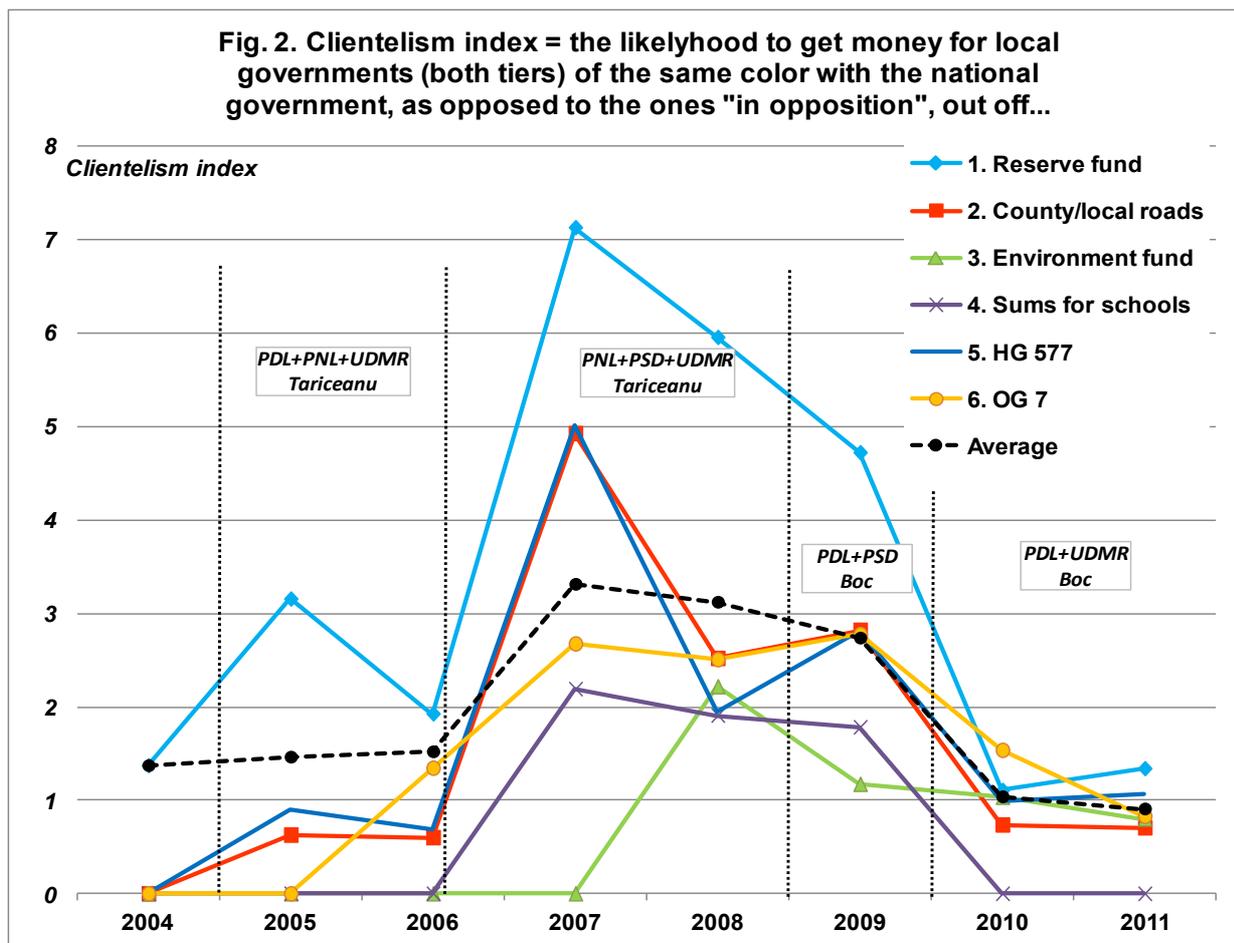
There is only one way to scrutinize completely and objectively the phenomenon: all the data should be made public for a longer period

and then one should check if the governments acted clientelistically using these instruments, using all of them or a particular one, namely if they tended to favour same political colour groups at the expense of the opposition.

EFOR is the first think-tank who succeeds to quantify the problem and appeals to a professional debate in order to limit or stop the disastrous practices.

More to the point, we computed the correlation between the sums transferred and the political affiliation of the mayors / presidents of County Councils, based on the aforementioned instruments of financial allocation. The political affiliation was quantified as an analysis variable for each electoral cycle, namely it was adjusted according to (i) each national election round; (ii) each local election; (iii) other significant changes of governmental majority happened between elections; (iv) political migration of a local elected representative.

Thereby, we devised an index of clientelism for allocations over a span of eight years under investigation. This index reveals what were the odds to receive funds at a certain moment in time if you belonged to the ruling coalition or power as compared with the resources distributed to opposition



representatives³. The values of the index for 2004-2011, for each of the instruments, are readily accessible in figure 2.

The conclusions are quite clear:

- We experienced a maximum of political clientelism between 2007 and 2008, on almost all the allocation instruments of transfers for current investments. On average, in 2007-2008 the probability of X to receive funds

³ The fraction between the sums received by local administrations from same political camp and the sums received by opposition, adjusted to the relative number of local administrations from each political camp.

was three times higher if he belonged to the same political camp of the ruling coalition than X being in opposition.

- The finding holds for almost all types of transfers under investigation and especially for the Reserve Fund, often the main topic of debates.
- Maximum of clientelism coincided with the period of rapid growth of public budgets before the crisis. **The main conclusion is that the affluence of resources in public budgets may end in worsening rather improving the system, given the fact**

THE INTERACTIVE MAP OF CLIENTELISM

The full data with allocations on the six instruments, 2004-2011, for each of the 41 County Councils and 3.228 Local Councils, can be found at

<http://expertforum.ro/harta-clientelism>

Click on a county or locality on the map of Romania and a table will pop up with the sums and political affiliation of mayors. The figures for 2012 will be added as soon as they become available.



that the state has weak institutions and a clientelistic tradition, depending on how correctly and efficiently is managed the surplus. If we choose as study case the funds transferred to schools, skyrocketing suddenly in 2007 (see Figure 1) without noteworthy results, the spending can be extremely inefficient (ineffacious). This is a pessimistic conclusion for the real impact of spending structural funds in Romania.

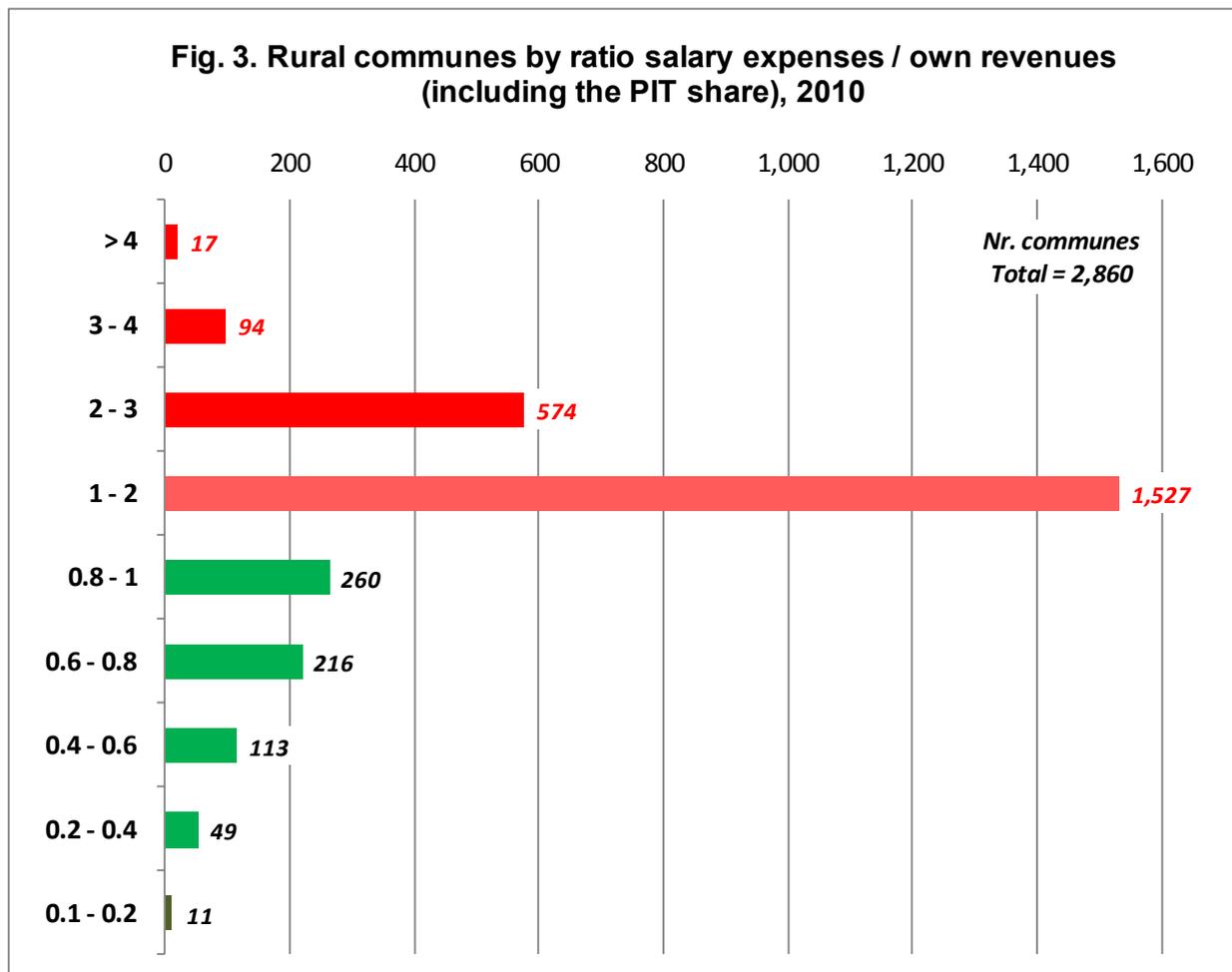
- Interesting and unexpectedly, a finding of the analysis is that independent⁴, at least theoretically, mayors took the lion's part of transfers, which is a strong predictor that discretionary allocations were used to encourage political migration of local representatives to power camp: as the law forbids changing officially political camps, the strategy was pursued

in informal ways and they are the first to be rewarded

- Local administration of UDMR is the only one with a political affiliation which benefited overall in the period analyzed, no matter regardless of the political power changes; this might be the only reliable basis on which a **model of consociational democracy** in Romania can be built
- Both the volume of sums allocated and the index of clientelism reached a peak in 2005, in the same time with a more close control of other types of transfers: particularly IVG (tax on general revenue) shares and equalization sums, for which the allocation formulae were ignored before 2004 and only afterwards the algorithm was respected. Put it in another way, **a massive form of clientelism was perceivable before 2005 too, but other tools were abused.**

A straighter control on these mechanisms led to the successful quest of new allocation channels, following a principle of communicating vessels. Based on scanty available data, our

⁴ The result applies to Republic Moldova case too.



supposition is that the phenomenon of political clientelism even dropped off a little bit after 2005.

Who is to blame and what is to be done? The biased allocations of investments funds were always blatantly obvious, but the tendency of favouritism was not equally distributed in the period under study. The phenomenon is not a benign one but on the contrary: the financial weakness of local authorities, especially of countryside local councils, makes them excessively dependent on these discretionary transfers.

The problem is of serious concern: less than a quarter (650) from all the communes in Romania (2860) succeed to cover completely the wages on the local level from own revenues and shares of personal income tax (IVG) which are monthly transferred⁵ (see Fig 3).

Even more dramatically, 25% of Romanian rural authorities known as communes (685) face operational costs with wages which are more than double than the basis of revenues – the ones highlighted with

⁵ These are the main sources of local budgets, roughly 48% from total sums, and the sole ones free of usage constraints.

a thick red line in figure 3. Given this fact, contentions for real autonomy right now, in ten or fifty years from now on, are nothing less than derisory, because there are no other major sources of revenues which may be directed to local administration without avoiding huge territorial disequilibrium, which in turn makes it compulsory to set up new tools of financial balancing, that is again centralization, and so the vicious circle goes on and on.

The only rationale of the existence of rural communes, from the beginning designed to slip into technical bankruptcy, meaning deprived of own resources and dependent on the ad-hoc grants negotiated with the county or the ministries in the above process described, seems to be preserving the basis of political clientele in the territory. The rational merge of rural communes and setting up of efficient administrative units, which may survive financially on their own, would mean a devastating blow to barons from any level, be it county, regional or central, than any other grandiose reforms.

This conclusion is substantiated furthermore by the fact that the system of administration in Romania, whether it retains its two tiers as today, or it will expand to three tiers if regions are settled, is one that generates cross political alignments, as in the situation in which the mayor belongs to the national ruling coalition and the rulers of County Council, as key

actors of managing sub-national transfers, are in the political camp of opposition.

In such circumstances it is difficult to conclude who abuses, or favours, who. For example, if the government overlaps the decisions of County Councils presidents and proceeds with a direct transfer to local authorities, it is possible either to favour a highly connected mayor, but also to compensate a local authority, which was victim to systematic neglect. In other words, discretionary allocation seems to be a rule both at central level and county level.

The only reasonable solution, corresponding to good practice standards, is to adopt clear contractual mechanisms for the territorial allocation of funds of any type, first and foremost investment resources and also emergency funds, based on objective and verifiable criteria, which can add predictability to the process. But the crucial point is observing the rules once they are agreed upon, and this is the weak link of governance in Romania. This study only lays the bricks for a later on debate about increasing transparency and robustness of financial allocations tools, which EFOR will start with relevant key actors in the near future.

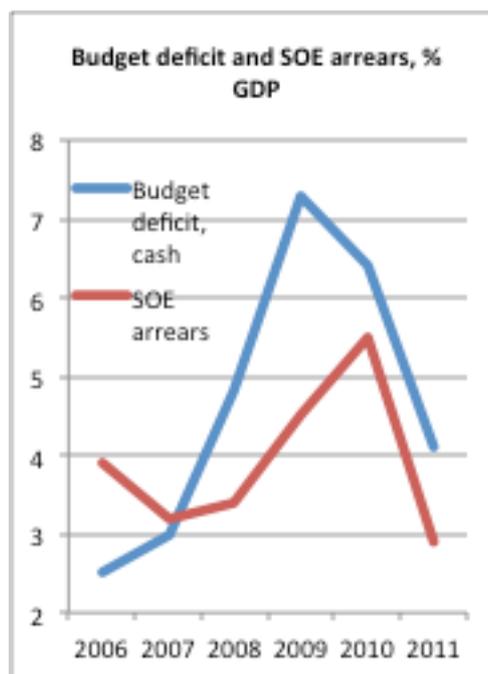
B. SYPHONING OFF RESOURCES FROM PUBLIC COMPANIES



Public budgets in the proper meaning are not the only resources which are used for discretionary or clientelistic allocations, as the study revealed in section A. On the contrary, for the example in the case of the IMF agreement, or the reports to European Commission, the decision making actors succeed to conceal deficits and arbitrary uses of resources in less visible areas: arrears or balance sheet of state owned enterprises. Even more, in extreme cases, the state can, by means of a discretionary regulation, to use also the resources of a private enterprise for a limited period of time.

The regulations on gas market in Romania from 2009 to 2010 stand

for a good example of this practice, as the government issued an Emergency Ordinance in order that big industrial consumers (energy and fertilizers producers) to gain preferential access to “cheap gas from domestic production”. Even if for a short period, the subsidize went on at the expense of two regulated suppliers, who were buying expensive gas and were coerced to sell cheap, the total loss exceeding 250 ml EUR. What was obvious for everyone, the financial haemorrhage was to be compensated by exacting from final consumers.



Although quite often, these situations are rather the exception, highly visible and temporary, otherwise the extorted private enterprises may close down the business, to appeal to international courts or simply move to another country. On the other hand, state owned enterprises are often involved

in corruption scandals with large amounts of money, and yet we are lacking strict control mechanisms to follow in a systematic and centralized manner the circuit of money at the disposal of these economic entities.

Why SOEs make good milking cows?

1. The first problem of state owned enterprises is that the distance between the manager and the share holder is more remote than in private companies. In state owned companies the final shareholder is the citizen, indirectly represented by a ministry or other public authority which supervises and controls the company. There is therefore a **twofold issue of principal-agent problem** (between the Ministry and the company; between the Ministry and the citizen), resulting in an accountability gap and shadowy transactions with preferred partners.

The more unclear the relations between the Ministry and the subordinated company, the lesser are the odds that a particular person to bear the burden of responsibility for theft and inefficiency. For example, who is to blame for the contracts with the so-called "smart boys", Hidroelectrica or the Ministry of Economy, since the contracts and

licenses requires all the signatures of the three mentioned.

2. A second problem is the fact that state-owned enterprises are not 100% "commercial"; usually they are also in charge of a public service function. State-owned companies are in the middle of two opposites:

- 100% commercial economic actor (the client, the consumer is the one who pays for the products of the company, for example, Oltchim)
- 100% public service (the state pays 100% the company's product in order to benefit the citizen).

A recent example is the company in charge of budget-funded highways. To shed more light on how a public service works, let us stress that a public company can administer natural monopolies (e.g., infrastructure networks); they can

After two years of struggle and under the whip of IMF we managed to count central public enterprises (roughly 700); on the local level we still do not know how many, what is their business and financial condition.

provide public goods (for example, security and defence), or goods provided free of charge to consumers who are not willing to pay but the society at large benefits out

of it (for example, vaccines); or it may be the case that the state has to tackle the spill-over effects (pollution) by means of direct management of such companies.

The problem is puzzling even in the most developed countries: to what extent the non-commercial functions performed by state owned companies can not be accomplished by private companies, using instead regulations and competitive-cum-transparent allocations of public resources?

Regularly, even if the state decides to accomplish further on these tasks by aid of a state owned company, the two functions should be completely separated, and the part of "public service" should be subsidized from public budget on clear terms of performance⁶. In reality, state owned companies proceed with **crossover subsidize between the two functions with the consequence that the manager can not be held at all accountable for some quantifiable and comparable criteria, for example company profit margin**. How many times did we hear the explanation that Hidroelectrica is not pursuing profit maximization as a reaction to the embarrassing questions likenwhy the company is not more profitable? Exactly this confusion is played to conceal discretionary allocations.

3. Eventually, state owned enterprises are less and unsatisfactory monitored. If international reports exist for public

⁶ Using the EU terms, this would be a Service of General Economic Interest (SGEI) and there are explicit good European practice rules which should be obeyed.

budgets, firstly for cash, secondly for arrears (ESA 95), public companies can proceed with arrearage or waste resources without a proper control of the money circulated through these companies.

Actually, a centralized list of these companies does not even exists, we don't know at the moment how many are; IMF succeeded to find out, after two years of investigations, that there are 700 companies at the level of central government and no one has a complete data base of companies, state-owned companies of public interest (known as "regii") or other forms of enterprises more or less commercially at the local level. It took almost two years until IMF and Finance Ministry managed to complete a database with 154 state-owned companies, property of central government, which still left aside smaller units as research institutes or local representatives of companies included in the database. As for data on local enterprises there is not yet a unified database of all economic actors and consolidated budgets which can be used for a panoramic view on all the money that circulates within the entire public system.

To the point, how the resources are stolen?

There are three main methods used to drain resources from state-owned companies:

1) over-estimated procurements. The companies sign procurements contracts without public bids, at prices higher than market prices, to the loss of the company and to the direct and personal benefit of company's executives, managers, or the ministry. The risk is known, that is why companies should observe the regulations on public procurements, to announce transparent and competitive auctions, exactly as other public institutions

2) underestimated sales. A less known risk, given the fact that there are only a few companies with "commercial" activities, as we explained above with the example of the highway company. In the commercial companies within competitive market sectors (for example, electric power producers) there is the risk that a particular state-owned company to sell to a favourite buyer at prices BELOW the market. The same applies as in the procurement: buying and selling within a state owned company should be organized in a transparent, non-discriminatory and competitive manner, to avoid a shadowy dealing between the executives of the companies and its commercial partners to steal together.

3) Although it is not a blatant source of rents, personnel appointments in the board and management of state-owned companies can lead to important waste of resourced caused by inefficiency, as professionals are

being replaced in a clientelistic manner with personnel of low quality and lacking skills. The political clientele may enjoy a warmly sinecure but the society's loss is substantial. It is difficult to balance stupidity against discretionary allocation in respect to state-owned companies which are net losers although some of them could have profit margins of hundreds of millions. Therefore we have to include in estimations inefficiency as net loss.

The problems described are well-known on their own and have outright solutions of corporative governance: for example, the OECD guide or international good practices on public procurements. To cut the long story short: the state has to define in a clear manner what has to do as full owner with these properties; how to approach the relation with minority share holders and respect their rights (for example, Property Fund); what rights can be assigned to external actors, such as the consumers or public opinion; how to increase transparency within activities of companies; to set up adequate, objective and clear criteria for the mission of a company, or the appointment of its executives. Observing these principles means also that state-owned enterprises will proceed on a competitive basis for their procurements and sales, and the state will obey non-discriminatory and transparent rules

when using public resources to finance state-owned companies.

What are the effects of discretionary allocation?

The fact that resources of state-owned enterprises are being misused in overestimated procurements, underestimated sales or wasted by inefficiency and incompetence, has major consequences overall the economy. The following effects, and actual examples, should be stressed:

- Resource waste from budget; loss-making SOEs need money from budget to cover losses in the balance sheet; or they can be highly profitable and are not, namely are not contributors to the budget, as it happened with Petrom (before privatisation) and Hidroelectrica;
- Arrears and financial stalemate which extends to private companies: for example, CFR (Romanian Railway Freight Carrier) a company involved in high corruption scandals which can not pay its suppliers due to lack of resources
- The market distortions, both in the sectors in which the company is present but also in related sectors of market. For example, crony contracts of Hidroelectrica distorts the power market but also the competition between suppliers

and big energy consumers, among which some benefit of “cheap energy” (Alpiq, Energy Holding, Mittal, Alro etc) and others do not. Similarly, when a company buys equipment or technology more expensive than market prices, then result is distortion of competition between equipment producers, as it was the case with Hidroelectrica and Voith Siemens, and Va Tech for the updating technology at power station on Olt river⁷.

How much is being stolen? Some quantitative estimates

If all the issues of corporate governance are known and the solutions are at hand, and also we know the negative effects of bad management in state-owned companies, the real scaling of the problem and how much discretionary allocation is in place are topics much less debated.

If we keep tracking the inefficiency of public sector as

⁷ <http://www.investigatiimedia.ro/o-misterioasa-bacterie-a-mancat-cu-spor-din-conturile-hidroelectrica-mai-mult-de-400-de-milioane-de-euro-costurile-retehnologizarii-hidrocentralelor-de-pe-oltul-inferior-par-acum-aruncati-pe-apa-ol/>

issues of discretionary behaviour (in crucial point is this: what impedes the state to hire real competent personnel?), then we can build two types of measurable variables:

1. Systemic indicators: IMF and Fiscal Council

The first systematic analyses on state-owned companies were drafted by IMF and the Fiscal Council⁸ – in fact, the first ones who succeeded to build the first database with state-owned companies at the central level of budget. Monitoring the state-owned enterprises by the two institutions is guided towards the global effects of bad management of companies on the public budget and economy.

State-owned companies are aggregated in the analysis regardless of the activity, commercial or non-commercial / public service oriented, which makes it difficult to understand real revenues and implicitly of real profit margins of the whole sector. For example, CNADNR receives as revenues transfers from budget for road building (without being profitable); CFR receives subsidises for passenger transport, which are compatible with EU standards of state help and if the service of general

economic interest is rightly defined, such a subsidy should be taken into account for profitability of the company.

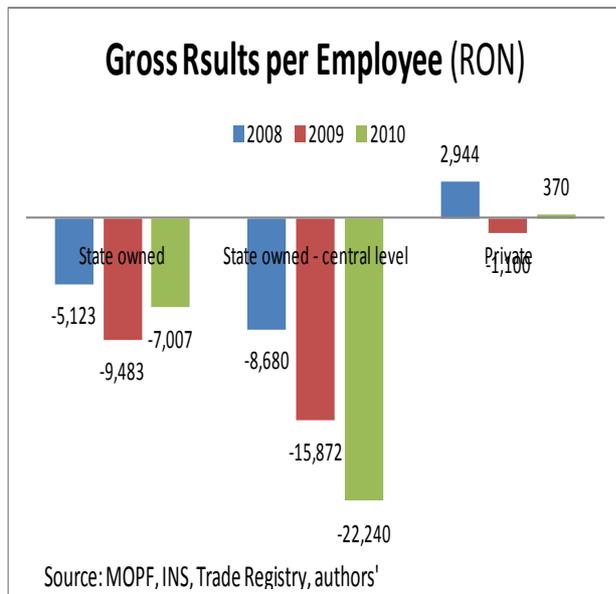
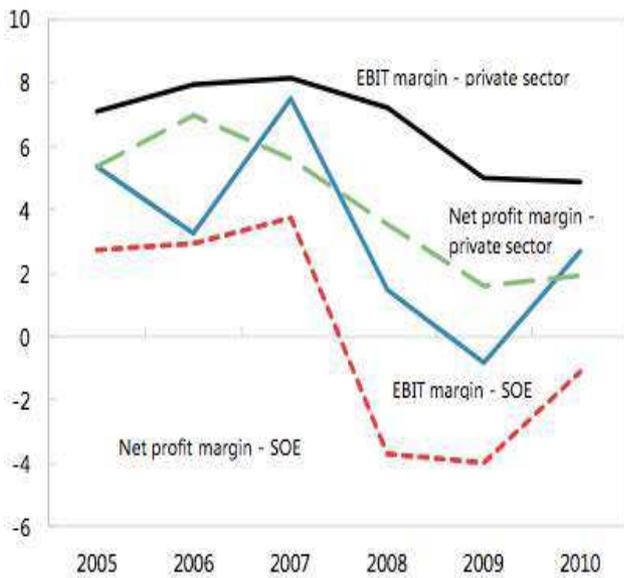
In the same time, an important part of big companies function on regulated prices (companies in power production, railroads). Therefore, global indicators as profitability margin (compared with private sector) measure in fact both the losses caused by corruption and discretionary allocation and the ones related to the difficulty of defining public services, an issue confronted also in developed countries of the West.

In principle, if the service of general economic interest would be straight defined (SGEI), the profitability margin in the public sector would be fully comparable with the one in private sector, due to the fact that transfers from state budget would limit to expenditure for services in the benefit of citizens and not a subsidy to cover inefficiency of a company; but as long as this tendency is new even enforce in the Occident, then the aggregated indicators would seem a little bit too demanding for Romania right now.

Aggregated indicators reveal that profit margin in public companies is lower than in private sector (fig. 5). The indicator would be of great help if “the service of general economic interest” would

⁸ See <http://www.consiliulfiscal.ro/Raport2011.pdf>.

Fig. 5. Profitability of SOEs



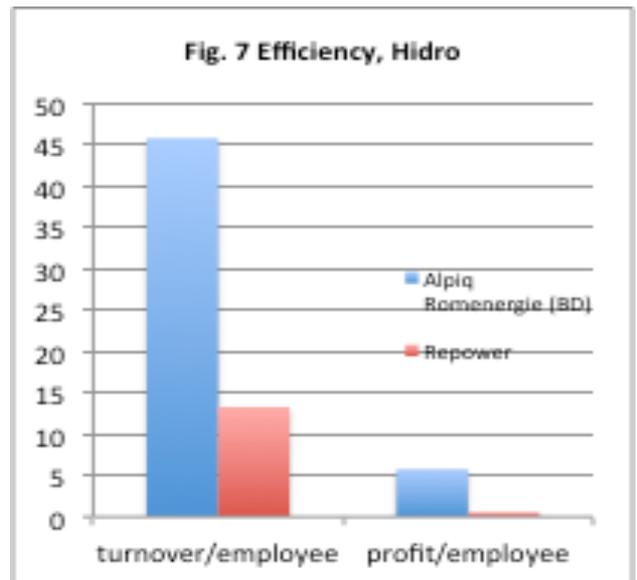
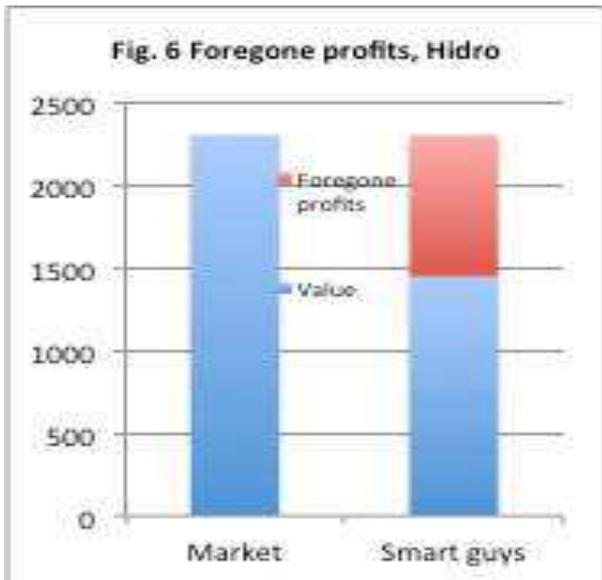
be well defined and transparently financed by means of a budget contract. As long as this remains an ideal, we can not realize if poorer results are explained by the general notion "Resources are stolen", or the fact that state-owned companies are cross-subsidising objectives from public services using commercial activities.

IMF and the Fiscal Council are trying to resolve this problem dividing companies in four categories: (i) profitable companies; (ii) viable companies but de facto in bankruptcy; (iii) solvable but not viable companies; (iii) companies which are both non-viable and bankrupt. CNADNR belongs to the category of solvable but not viable ones. In fact, if the public service would be rightly defined and financing sources corresponding to theory, CNADNR could be a profitable company, benefiting of revenues in form of the user charges for preserving infrastructure plus transfers for new buildings; and on the side of expenditures would be the works contracted according to the two sources of financing.

2. Sector-based indicators

We are conceiving another type of indicator, which takes into account the issues signalled above. The main disadvantage of our indicators relies in the fact that we could not build a sole variable to compare overall the performance in state-owned companies, in a cross-sector manner, in order to put the finger on discretionary allocations. So, we have:

a. Sales of companies within competitive sectors.



For example, in power supply sector, Hidroelectrica sold in 2011 an amount of 12 TWh @ 121 Ron/MWh, the market price being 192 Ron/MWh as average in 2006-2011. The lost profit is therefore 852 million Ron (roughly 200 million Eur). Here can be calculated:

- Total profits lost by power stations, in a longitudinal analysis as compared with other countries; profitability (profit margin on turnover); Fig.6
- Equalling inefficiency with discretionary allocations (e.g., poor management selected on clientelistic criteria) opens the way to direct comparisons between output of state-owned company per personnel number or capital / output of private companies, in cases where the state-owned company has private competitors (a large number of rich sectors, such as

energy, freight railroad transport) Fig.7

- The profits of partners in these transactions contrasted with the profits of other companies which are not buying using privileged relationships

Indicators can be computed on large sectors: electric power, gas, freight railroad transport, which is more relevant for discretionary allocations if one can investigate drained resources in correlation with the relations between the owners of private actors and responsible persons from state-owned companies.

b. Procurement:

For example, in the railroad sector there are cost-standards available in open sources. It is well known that CFR spent twice as much with modernisation works per km for Bucharest-Constanta railroad, and inefficiency is one explanation.

Another example is Hidroelectrica, which bought expensive energy from Termoelectrica in order to pay excessive contractual obligations to the so-called "smart boys". Another sample is useless investments or inefficient ones, such as the case above with Hidroelectrica and the power stations on Olt.

There it can be estimated:

- Total profits lost by power stations, in a longitudinal analysis as compared with other countries; profitability (profit margin on turnover)
- Equalling inefficiency with discretionary allocations (e.g., poor management selected on clientelistic criteria) opens the way to direct comparisons between output of state-owned company per personnel number or capital / output of private companies, in cases where the state-owned company has private competitors (a large number of rich sectors, such as energy, freight railroad transport)
- The profits of partners in these transactions contrasted with the profits of other companies which are not buying using privileged relationships. For example, in an analysis published last year within SAR projects, the Romanian constructors recorded

- systematically profits and
- revenues much higher than foreign companies.

As in the case of sale, indicators can be computed on large sectors electric power, gas, freight railroad transport, which is more relevant for discretionary allocations if one can investigate drained resources in correlation with the relations between the owners of private actors and responsible persons from state-owned companies.

The concluding remark is that we can define several types of indicators by means of which one can objectively measure the discretionary allocation of public resources within state-owned companies – see the general table at p.22. This set of indicators may be useful including inter-state comparisons, if a judicious methodological premise finds its place by taking into account the local particularities when operationalisation of variables is completed. Once this working mechanism is understood, it can be added, together with the clientelism index for allocations in local administrations discussed in the earlier section, to the tool box of indicators which can be successfully used in monitoring clientelism and good governance in EU.

Fig. 8 Turnover, Romanian companies

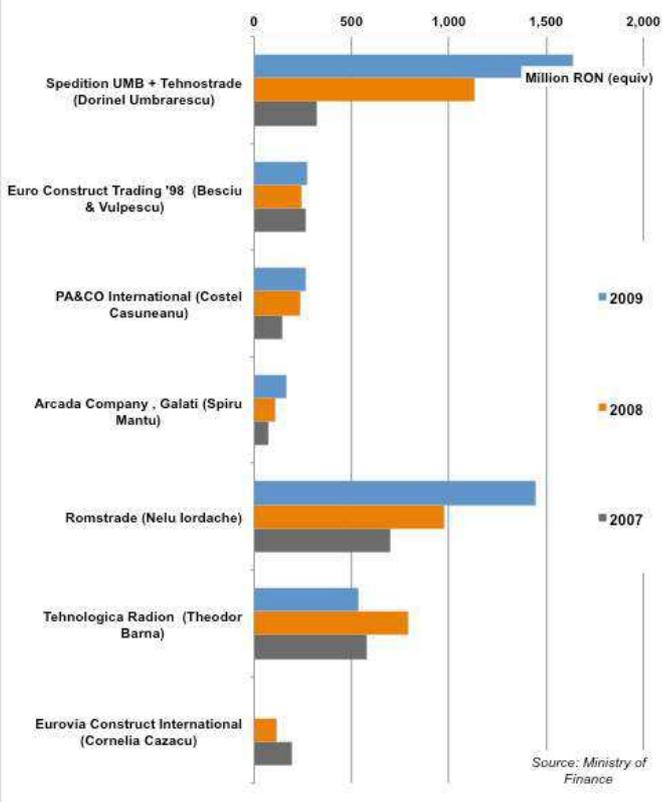


Fig. 9 Gross profit, Romanian companies

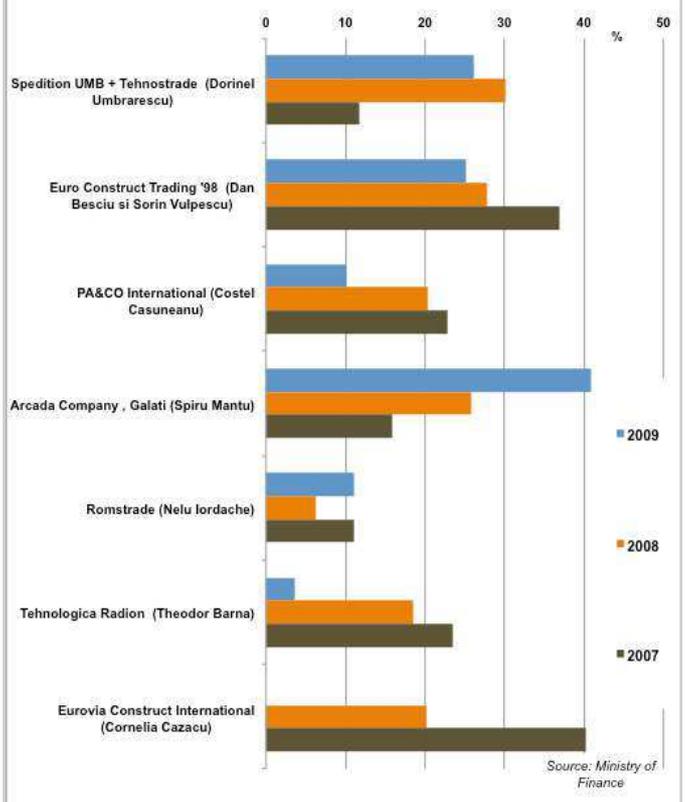


Fig. 10 Turnover in Ro, foreign companies

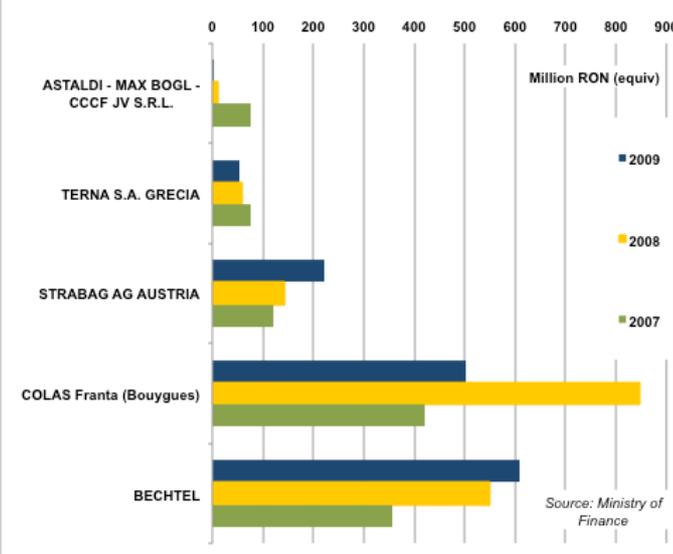
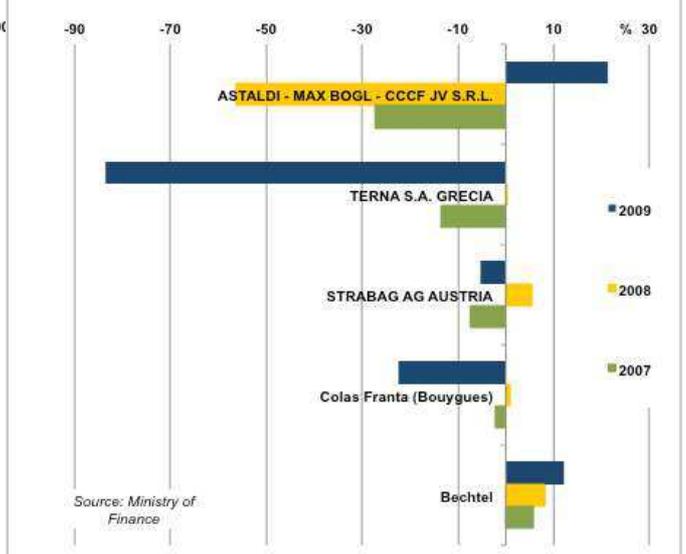


Fig. 11 Gross profit in Ro, foreign companies



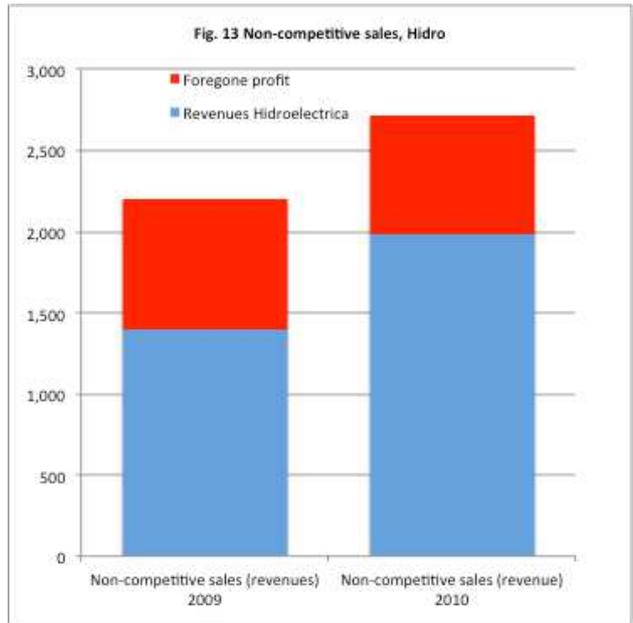
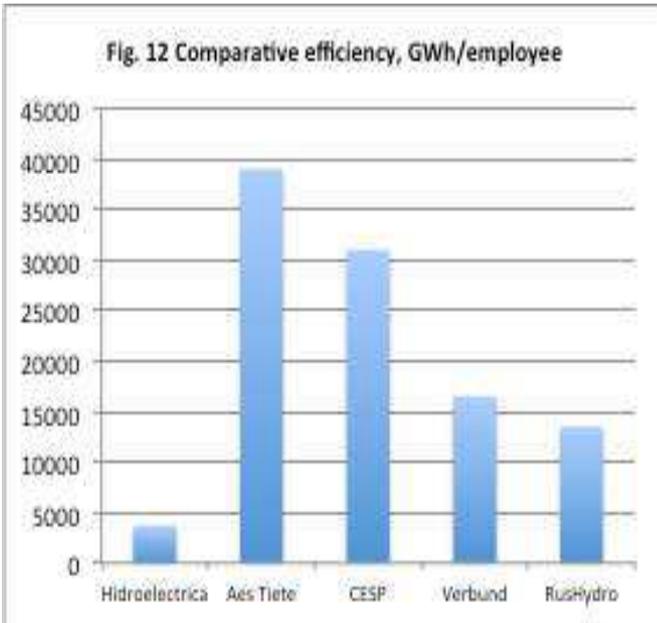


Table – summary of indicators to measure clientelism in SOEs

Indicator	Across time	Across countries	Across sectors
SOE profitability	X	X	X, with limitations
Foregone profits (unrealized revenues, overstated spending)	X	X	
Profits of favored partners compared to other companies in same sector	X	X	
Output / input	X	X	

