Report No. 38357-RO

Romania
Municipal Finance Policy Note

June 3, 2008

Poverty Reduction and Economic Management Unit
Europe and Central Asia Region

Document of the World Bank

CURRENCY EQUIVALENTS
(Exchange Rate Effective June 3, 2008)

Currency Unit = New Romanian Leu (RON)
US$1 = 2.343

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ANAF	National Revenue Authority
ANRSC	National Regulatory Agency for Municipal Services
ARBAC	Bucharest Regulatory Agency for Water Supply and Sewerage
BCR	Romanian Commercial Bank
BSE	Bucharest Stock Exchange
CEC	Romanian Savings Bank
CIT	Profit Tax
CNVM	Security Exchange Commission
EU	European Union
IDR	Issuer Default Rating
IFIs	International Financial Institutions
ILGU	Inter Local Government Union
IMF	International Monetary Fund
LBAC	Local Borrowing Authorization Commission
LGI	Local Government Initiative
LGU	Local Government Union
LLPF	Law on Local Public Finance
MIRA	Ministry of Administration and Interior
MoEWM	Ministry of Environment and Water Management
MEF	Ministry of Economy and Finance
MRD	Municipal Repair and Development Fund
MSC	Municipal Services Company
NBR	National Bank of Romania
NDP	National Development Plan
NGO	Non-Government Organization
OBA	Output-Based Aid
PCG	Partial Credit Guarantee
PDL	Public Debt Law
PFI	Private Finance Initiative
PIT	Personal Income Tax
PPP	Public-Private Partnership
PRG	Partial Risk Guarantee
RDA	Regional Development Agency
SOP	Sector Operational Plan
SPV	Special Purpose Vehicle
VAT	Value Added Tax

Vice President:	Shigeo Katsu
Country Director:	Orsalia Kalantzopoulos
Sector Directors:	Luca Barbone (ECSPE); Fernando Montes-Negret (ECSPF); Peter Thomson (ECSIE)
Sector Managers:	Ronald E. Myers (ECSPE); Gerardo Corrochano (ECSPF); Motoo Konishi (ECSIE)
Task Team Leaders:	Amitabha Mukherjee/Joao Oliveira (ECSPE); Michel Noel (ECSPF); Sudipto Sarkar (ECSIE)

Acknowledgements

Assistance, insights and information received from the authorities in Romania during the preparation of this Note is gratefully acknowledged.

This Note was prepared by a team comprising Messrs./Mmes. Amitabha Mukherjee, William Dillinger, Joao Oliveira, Casandra Bischoff (ECSPE); Michel Noel, Sorin Teodoru (ECSPF); and Sudipto Sarkar (ECSSD). The draft report was submitted to the Government in March 2007. The Government provided detailed comments on two sections of the report--the current chapters 1 and 3--in June 2007. These comments on the two chapters have been fully addressed in this final version of the report.

Management oversight was provided by Sector Managers Messrs./Mmes. Deborah L. Wetzel and Ronald E. Myers (ECSPE); Sumter Lee Travers (ECSIE) and Gerrardo Corrochano (ECSPF). Guidance and comments from Messrs./Mmes. Satu Kahkonen and Ronald Hood (ECSPE); Marianne Fay (ECAVP); Benoit Blarel (ECCU5); Keith McLean (ECSSD); Ellis Juan and Maria Freire (FEU) are also gratefully acknowledged.

ROMANIA
MUNICIPAL FINANCE POLICY NOTE

TABLE OF CONTENTS

Romania
Municipal Finance Policy Note

EXECUTIVE SUMMARY

i. Municipalities play an important role in the Romanian public sector. They provide a variety of infrastructure services, either directly through municipal service companies, or through concessions. Among these services, water, wastewater, and solid waste assume particular prominence in the context of EU accession, as Romania has undertaken obligations for their upgrading under the environmental *acquis*.

ii. *Local Administration and Finance* Throughout the 1990s and into the first years of the present decade, problems in the structure of intergovernmental relations undermined efforts to achieve efficiency in public service provision and generate savings for investment in local infrastructure. Ambiguities in the role of the centrally-appointed *prefect* and a lack of clear functional definitions in the organic law weakened accountability. The system for financing municipal government was particularly problematic. Romanian local governments rely heavily on transfers. The lack of clear rules for distributing transfers created uncertainty and allowed excessive influence to be exercised by central authorities and counties.

iii. The 2006 public administration reform has addressed many of these problems. The position of *prefect* has been delimited and professionalized. Recent legislation has clarified the functional responsibilities of each tier of subnational government. The recently adopted intergovernmental transfer formula also removes most of the discretion from the allocation system.

iv. The effort to delimit the functional responsibilities of each tier of government has not yet been fully implemented, however. Plans for sectoral decentralization may contain the seeds of a solution. The proposed education decentralization strategy—although currently on hold—would provide an opportunity to more clearly define the respective roles of the Government, subnational governments, and individual schools in this sector. Certain relatively minor changes in the system of intergovernmental transfers also bear consideration.

v. *Water Utilities*: The water sector will bear the brunt of the financing required to comply with EU environmental standards. Total investment costs are estimated at €9.7 billion between 2005 and the end of the compliance period. While EU Cohesion and Structural Funds will be the main external financing source for the envisaged municipal investments, substantial counterpart funding will be needed. Given the fiscal constraints faced by central government, much of this counterpart funding will have to be raised at the sub-national level.

vi. In principle, such funds could be generated by raising tariffs. At present, tariff revenue covers only two-thirds of water companies' operating and investment expenditures. But recent studies show that even modest increases in tariffs could be difficult for the poorest 40 percent of the population. While tariffs should be allowed to increase, the burden on the poor should therefore be reduced through targeted subsidies. One approach would be to extend the social protection system now used in the district heating sector to cover water and wastewater services. Additional revenues could be raised from development fees, contract fees and the creation of a municipal repair and development (MRD) fund. Further resources for investment could be generated by continuing to reduce operating costs.

vii. *Domestic Credit:* Access to domestic credit can also be an important means of augmenting funding for infrastructure investment. In recent years, the local government debt market has taken off rapidly, although from a very low base. Domestic currency loans by commercial banks to local governments increased from RON 3.6 million in 2001 to RON 1,399 million in 2006 (or US$ 498 million). But the present structure leaves the Government vulnerable to pressure for debt relief, while encouraging lenders to take excessive risks.

viii. The current Law on Local Public Finance (LLPF) requires the MEF to provide *ex ante* authorizations of local government borrowing on a case by case basis. In effect, this requires it to assess the creditworthiness of local governments for each new borrowing operation. The LLPF also allows a local government to guarantee its debt by pledging its own revenue; a guarantee that is exercisable through the Treasury. Both provisions involve the Government too closely in what should be a distinct transaction between a local government and a private lender. By approving individual loans and acting as an administrator of debt guarantees, the government may be unintentionally signaling markets that it stands as a *de facto* guarantor on all municipal debt. This is likely to give rise to reckless lending (on the part of creditors) and pressures for government bailouts (on the part of local governments).

ix. In response, MEF ex ante controls over local borrowing should be gradually phased out and replaced by market mechanisms (e.g. credit rating agencies). Other aspects of local debt regulation should also be revised. The legislation governing municipal financial crisis/insolvency procedures should clarify issues such as the definition of "essential municipal services" and the support the Government could provide (Treasury loans, allocations from the Government reserve fund) to local governments undergoing plans of financial or insolvency recovery. Methodological norms for the application of the local public finance law should specify how the Risk Fund should be used. It would be advisable for NBR to adjust its reserve requirements for municipal loans to reflect local credit ratings, with a risk weight of 100 percent required in the absence of a credit rating. Finally, the Government should design and implement a coherent strategy to improve access to credit markets by local governments in the context of the EU single market. This strategy should consist of a range of technical assistance and financial support instruments carefully modulated on the basis of the risk profiles of particular sub-national entities in Romania.

Romania

1. LOCAL GOVERNMENT ORGANIZATION AND FINANCE

1.1 Romania needs substantial municipal investments to improve its local services and bring them to the standards required by the EU acquis communitaire. While the EU will finance a large part of these investments, substantial counterpart funding will need to be mobilized from domestic sources. Given the fiscal constraints faced by central government, much of the counterpart funding will likely have to be raised at the sub-national level, i.e. by local governments and municipal corporations. This policy note examines Romania's local government fiscal framework and sub-national debt market to see how improving them could facilitate absorption of EU funds and improve local service delivery.

1.2 The policy note is organized as follows. Section I reviews the local government structure and fiscal system and discusses how it can be improved to better enable local governments to efficiently fulfill their functions. Section II then examines the state of municipal utilities. Section III examines the recent evolution, opportunities and challenges ahead for the development of the sub-national debt market, analyzes key deficiencies and proposes priority reforms in the legal and regulatory framework for local government borrowing, and proposes a strategy to increase the access of sub-national entities to the sub-national debt market, based on a range of technical assistance and financial support instruments carefully attuned to sub-national entities' risk profiles.

ORGANIZATIONAL ISSUES

1.3 Romania is a large, unitary state. Its Constitution provides for a "public administration in territorial-administrative units based on the principles of local autonomy and decentralization of public services" (Art. 119). It also establishes (Art. 120-122): (i) directly elected local and county councils as deliberative authorities; (ii) directly elected local mayors and indirectly elected county council presidents as executive authorities; and (iii) centrally appointed prefects as coordinators for deconcentrated central agencies and supervisors for local self-government acts in each County. Prefects have the authority to check the legality of the local council decisions and to suspend *de jure* the decisions of the local councils, if they consider those decisions illegal.

1.4 Local authorities' organization, functioning, rights and responsibilities are specified in Law 215/2001 on "Local Public Administration" (amended and supplemented by Law 286/2006); the Framework Law 195/2006 on Decentralization; Law 188 on the Statute of Civil Servants (amended and supplemented by Law 251/2006); and Law 340/2004 on the role of prefects (amended and supplemented by GEO 179/2005). Intergovernmental fiscal relations are regulated by Law 273/2006 on Local Public Finance, while Title IX of the Romanian Tax Code (Law 571/2003 and amendments) specifies local taxes and fees. Law 500/2002 on Public Finance and Law 158/2005 on the Local Borrowing Authorization Commission regulate local government budgeting, auditing and debt management. Law

326/2001 regulates municipal public services (including off-budget local utility providers). Law 213/1998 on regulates local government property ownership. However, the extent to which State properties have legally and effectively been transferred to local authorities is not entirely clear, since registration procedures and the organization of the cadastre system are still in flux.

1.5 As of 2005, the structure of subnational government consisted of: (1) 3,127 local governments (consisting of 104 municipalities, 207 towns and 2816 communes, and (2) 42 county governments (judets). (See Table 1.1)[1] There are also 42 prefectures, with coordinating and supervisory functions, whose jurisdiction geographically coincides with those of the counties. As part of the preparation for the EU accession, eight Regional Development Agencies (RDAs)[2] were established in 1998. However, without executive/legislative powers or separate budgets, the RDAs have yet to take on a significant role.

Table 1.1: Romania - Administrative Structure, 2005

Deliberative bodies	*under jurisdiction of:*				*Adm. Units*
	Central Government		*Local Self-Govt.*		
	State	*Prefectures*	*Counties*	*Localities*	
Parliament/Government	1				1
Supervisory/Coord.		42			42
County Councils			42		42
Local Councils/Cities				104	104
Local Councils/Towns				207	207
Local Councils/Communes				2816	2816
Total	**1**	**42**	**42**	**3127**	**3212**

Source: Ministry of Finance

1.6 In fiscal terms, the degree of decentralization in Romania is fairly typical of other unitary European countries. As shown in Figure 1.1, local expenditures (including both county and local governments) were equal to about 23 percent of general government expenditure in 2004. This is considerably smaller than in the Scandinavian countries, but similar to other recent EU accession countries. Local government expenditure figures exaggerate the degree of local control over public spending, however, since they include teachers' salaries, a central government delegated function where local authorities act as payment agents without any decision making powers over salaries or employment[3]. Local government discretionary expenditures tend to be focused on municipal public services and on topping up central government expenditures on certain delegated social services.

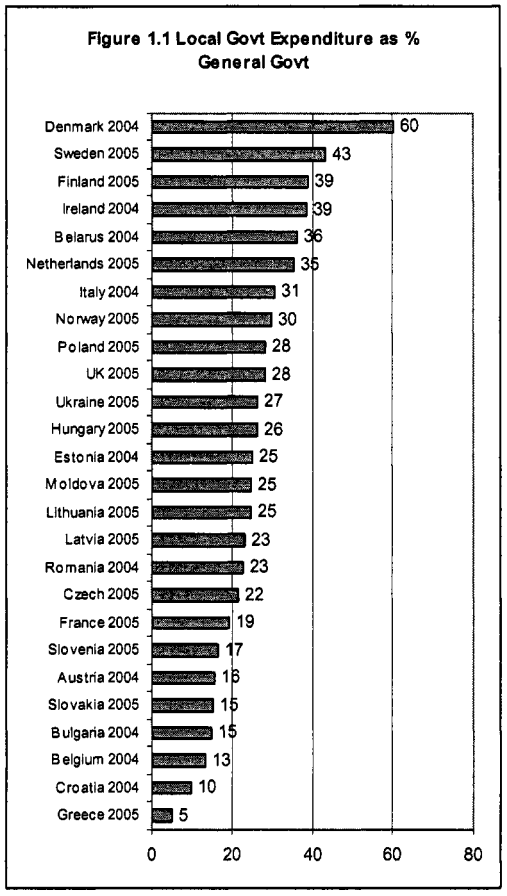
[1] Bucharest municipality has a special status equivalent to a County, and is subdivided into six Sectors. Diagram 1.1, Annex I.

[2] With population between 2 and 3 million and surface size between 30 and 37 thousand square kilometers (except Bucharest).

[3] As a result of this transfer the share of local budget in national education expenditure jumped to 56 in 2001, from 10 percent during the period 1995-2000.

Clarifying the Assignment of Responsiblities

1.7 Prior to 2006, local government responsibilities were not clearly defined. The organic Law on Local Public Administration (Law # 215/2001) regulates the organization and functioning of county and local council authorities (deliberative and executive) but focuses on processes and procedures, rather than the assignment of specific responsibilities. Separate laws, emergency ordinances, official government decisions, and the State annual budget law governed the role of local government in specific sectors, albeit not always consistently.[4] By and large, the Government retained most policy decision-making powers at the center, while local governments were responsible for implementation. Counties were charged with coordinating local service delivery, including the task of balancing local government budgets through equalization transfers.



1.8 In 2006, the Cabinet approved a Memorandum defining the role of county and local governments and distinguishing among exclusive, shared and delegated functions. The Memorandum includes two annexes, describing the specific role of each tier of subnational government in the regulation, implementation, and financing of specific services and in the ownership of related facilities. As shown in Annex Table 1.2, county governments would bear responsibility for delivering water supply (if a regional operator has been created), county roads, public transport (in conjunction with private operators), the maintenance of county-level health clinics and the county guard service. The central government would bear exclusive regulatory responsibility in all these areas and would retain a role in financing county roads and the maintenance of health clinics. As shown in Annex Table 1.3, local governments would retain an extensive list of functions, including water supply (if not provided by a regional company), district heating, waste management, local public transport, local street maintenance, and certain aspects of health care, education, and social assistance.

[4] This legislation includes, among others, Laws No. 84/1995, 128/1997, 270/2003, 634/2002, 194/2003, 3/2003, 194/2003, 475/2003, 284/2002, 114/2002, 363/202, 481/2004, 17/2000, 217/2003, 416/2001, 343/2004, 481/2004, 15/2005; EOG 70/2002, 32/2002, 35/2003 , 73/2002, 25/2004; GD 348/2003, 400/2003, 539/2005, 828/2003, 955/2002, 1007/2005, 1021/2000, 1386/2003, 1491/2004, 1561/2004, 1591/2002, 1353/2003, 433/2004, 346/2004; Ord 29/N/1993, 68/2003, 70/2002, 73/2002, 259/2004, 233/2004; HG 933/2004

1.9 While the Cabinet Memorandum represents an important effort to define the respective responsibilities of each tier of government, ambiguities and overlaps nevertheless remain. Some functions are assigned to both county and local governments. In the area of socio-medical assistance services, for example, local governments are responsible for 'ensuring proper conditions for service delivery', while the social medical assistance unit, subordinate to the central government, has the responsibility of delivering the service. In some other cases the responsibilities are assigned on an optional basis. Shelters for the elderly, for example, may be provided by local governments, but only if they 'undertake it as an exclusive responsibility and have the necessary administrative capacity.' The Ministry of Interior and Administrative Reform is still working in defining criteria for the 'administrative capacity'.

1.10 To an extent, the problem has been worsened by stalled efforts at functional decentralization. The decentralization of police responsibilities, for example, was intended to establish community police units at the local level. Major problems occurred after the functional competencies were reallocated, however, with a vast number of small local government units unable to establish the new community police units due to lack of resources. (See Box 1) Reforms in social assistance were intended to permit local governments to top up entitlements but have left several areas of undefined responsibilities between county and local councils.

1.11 In 2006, an Inter-ministerial Working Group was established to design and coordinate the implementation of sectoral decentralization policies. However, the Working Group has met only a few times since then and has not been able to reach a consensus on major issues. Plans for further sectoral decentralization, nevertheless, hold the seeds to a solution. The new education decentralization strategy proposes to shift more authority to school boards. Although the strategy is currently on hold, it would provide an opportunity to more clearly define the respective roles of the Government, subnational governments, and individual schools in this sector.

Delimiting the role of the prefect

1.12 Under article 112 (4) of the Constitution, the prefect has de jure authority to immediately suspend local self-governments' decisions if he deems them illegal and challenges them in Administrative Court. Until recently, the excessive powers of prefects undermined local government autonomy. Prior to 2006, prefects were political appointees.

Box 1.1 Decentralizing the Police

In preparation for EU accession, Romania adopted a law (371/2004) establishing local community police, who were to take such functions as patrolling and guarding from the national police. The devolution was to be carried out by creating Community Police Units at the local level, using funds and staff transferred from the existing Safety and Patrol Units. What seemed simple in theory became a complex in practice. It was quickly discovered that the Safety and Patrol units did not have enough resources themselves and therefore had few to transfer. In some cases, community police units were given only bats but no guns. Hiring criteria also proved to be a problem. Staff in the community police units were required to meet a minimum schooling requirement of twelve years, rendering almost half the staff of the Safety and Patrol Units ineligible. As a result, one year after the law went into effect, only half of large cities and only four percent of communes had established the Community Police Units.

They had the authority to appoint the secretaries of local and county councils, which gave them indirect influence over local decision-making.[5]

1.13 The 2006 public administration reform addressed most of these concerns. The role of the prefect was reviewed and depoliticized by transforming the position from that of a political appointee to a high civil servant and by promoting a more active role for the Administrative Courts in conflict resolution. Starting with 2006 the prefects are selected through a national competition held by a permanent independent commission appointed by the Prime Minister. The members of the commission are appointed by rotation and have a predetermined ten and a half year mandate. In addition a general performance appraisal of each high civil servant must be carried out every 2 years. The reform also provided that secretaries of local authorities would be appointed and dismissed by the local authorities themselves, instead of by the prefect.

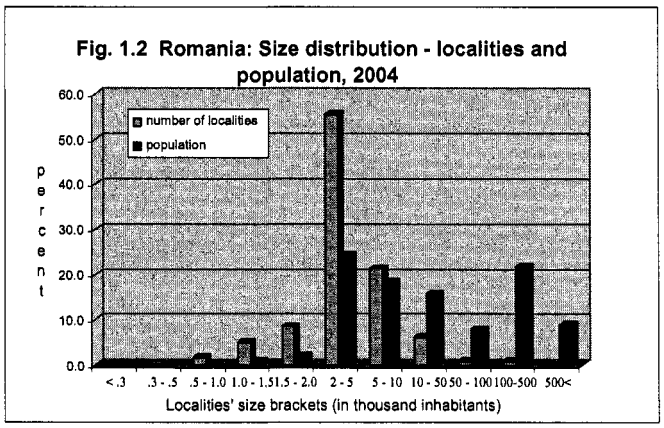
Addressing jurisdictional fragmentation

1.14 Many of Romania's local governments are quite small. As shown in Figure 1.2, 92 percent of local administrative units have less than 10,000 inhabitants and 71 percent have less than 5,000. These two groups of units cover 45 percent and 27 percent of the population respectively. It has been argued that, due to their small size, such governments cannot exploit economies of scale and have difficulty attracting qualified staff. International evidence suggests otherwise. International efforts to demonstrate economies of scale in the provision of municipal services have generally proven inconclusive.[6] The evidence suggests that population size is not a decisive variable in determining the cost or quality of public services. The literature suggests, in fact, that where populations are geographically dispersed, there are few technical economies of scale to be gained by incorporating them into a single large jurisdiction. It does, however, suggest that there are economies of scale in the use of skilled (and therefore expensive) staff. These however, can be addressed by contracting with private providers, joint service arrangements, or by employing skilled staff on a part time basis. (It is worth noting that Romanian local governments are not particularly small by European standards. As shown in Table 1.4, they are considerably larger, on average, than local governments in Germany or Spain and more than four times the size of the average French commune.)

[5] Although Law # 215 states that there is no hierarchical relationship between local public authorities and County Councils, this provision is honored in the breach.

[6] This literature is surveyed in Dillinger, William. 2003. *Latvia: Beyond Territorial Reform* (World Bank Report No. 25466-LV) and in William F. Fox and Tami Gurley. 2005. *Will Consolidation Improve Sub-National Governments?*

Table 1.4 Average Population of Municipalities in Selected European Countries	
Country	Average Pop.
Great Britain	126,128
Lithuania	66,300
Sweden	30,040
Netherlands	27,559
Denmark	18,760
Belgium	16,960
Poland	15,561
Finland	10,870
Norway	9,000
Italy	7,105
Romania	**6,900**
Estonia	5,713
Germany	5,575
Latvia	4,400
Spain	4,930
Austria	3,421
Hungary	3,242
Switzerland	2,468
Czech Rep.	1,659
France	1,580



1.15 There is a final lesson to be drawn from international experience. Territorial consolidation can be extremely unpopular. Small communities resist incorporation into larger jurisdictions, fearing their interests will be submerged in the larger polity. Among the recent EU accession countries, only one (Lithuania) has successfully implemented a territorial consolidation in the post-Soviet period. If such resistance exists in Romania, the costs of attempting consolidation may not be worth the effort. Efforts at improving the efficiency of local government could instead focus on facilitating intergovernmental cooperation and the use of private contractors.

REVENUE ASSIGNMENT AND INTERGOVERNMENTAL TRANSFERS

1.16 The assignment of revenues to local government in Romania is regulated by Law 273/2006 on "Local Public Finance" and Title IX of the Romanian Fiscal Code (Law 571/2003 and amendments). As shown in the chart below, the largest single source of local government revenue consists of earmarked transfers, accounting for about 36 percent of the total. These largely consist of funding for teachers' salaries. As noted earlier, local government have virtually no say in the use of these funds, acting merely as paying agents. Issues in the financing of education are beyond the scope of this paper.

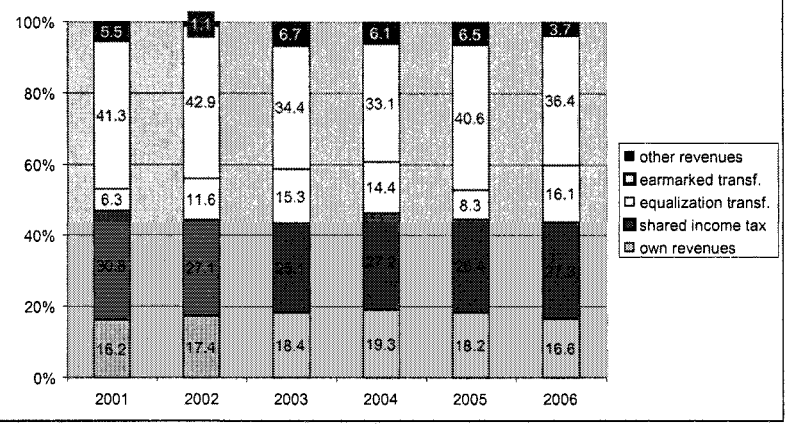
1.17 *Local own taxes, fees and charges.* The sources over which local government do have some discretion fall into three categories. The first, local own taxes and fees, accounted for only about 17 percent of total revenues in 2006. These include property taxes (on buildings, land, and motor vehicles) and a hotel tax. While the base and reference rates of property taxes are determined by law, each local or county council can adopt a rate up to fifty percent higher or lower than the reference rates. There are also a myriad of legally regulated fees, most of them belonging to local councils (e.g., advertisement fees, entertainment fees, temporary road use fees). Some are shared with county councils (e.g., planning licenses, building permits, business registration fees). Some are special fees and charges that either the local councils or county councils are allowed to establish and collect.[7] Local tax administration in Romania is decentralized. Each

[7] E.g., late payment interest and fees, judicial stamps, stamp duties, extra-judicial stamp duties, sanitary-veterinary fees, slaughter house fees, dog license fees, hunting and fishing fees, disease and pest control fees, nursery school fees, and other fees.

administrative unit is allowed to administer its own taxes, fees and charges. In general communes and small towns use the tax administration services of the respective county. All such revenues must transit the National Treasury system[8] and are therefore subject to a certain degree of central government control.

1.18 *Shared taxes* Shares of profit and income taxes[9] account for about 27 percent of local revenues. These are distributed among subnational governments on a derivation basis, according to the taxpayer's place of work.[10] Funds are distributed among the tiers of government as follows: 47 percent remains with local governments, 13 percent with the county council, and 22 percent is allocated to an "equalization pool" at the county level for subsequent distribution to local government on the basis of a formula, discussed below.[11] The remaining 18 percent is retained by the central government.

Figure 1.3 Romania: Composition of Local Govt. Revenue



1.19 *Equalization transfer* The third major source of discretionary revenue, accounting for 16 percent of the total, is the so-called equalization transfer. Romania has been experimenting with formulas for distributing the equalization transfers for several years. Previous versions were criticized for their complexity and for the degree of discretion they granted to counties. (As noted earlier, counties had the authority to allocate equalization grants among their respective local governments at their own discretion.)

1.20 A new system went into effect in January of 2007.[12] It consists of six distinct steps. First, a lump sum is allocated from general central government budget revenues. When the system was first promulgated, it was announced that the lump sum would be based on a combination of the unshared portion of the PIT--the remaining 18 percent--and the VAT. In the event, the amount was determined at the discretion of the government. It was

[8] All operations of the consolidated budget (comprising all the Romania budgetary system: including the State Budget, the Social Security System, Special Fund Budgets, institutions fully or partially financed by the State budget, and the Local Budgets) has to be registered by the National Treasury System.
[9] Including personal income (PIT), and incomes of independent activities and micro-enterprises.
[10] The profit tax liability of local government's autonomous public enterprises ("regies autonomones," including utilities) is directly collected to the respective administrative unit's budget, but profit taxes from all other sources belong to the State budget.
[11] Bucharest City budget retain 47.5%, Bucharest City district budgets retain 23.5%, and 11% goes to an "equalization pool" to be subsequently allocated to Bucharest City district and Bucharest City.
[12] Certain aspects of the law, including the division of equalization funds between counties and local governments, went into effect during 2006.

reflected in the annual budget law, rather than in permanent legislation, and is therefore subject to annual change.

1.21 The lump sum is then distributed among counties. Thirty percent is distributed on the basis of land area. Seventy percent is distributed on the basis of 'fiscal capacity'. This is determined by calculating a 'fiscal gap' for each county as the difference between the per capita PIT tax revenues of the county and the average for all counties, multiplied by the population of the county. Fiscal gaps are then aggregated for the country as a whole. Each county's share of the aggregate fiscal gap determines its share (of this portion) of the lump sum.

1.22 For each county, these shares are then added to the 22 percent of the PIT collected within each county to form a consolidated pool. Twenty five per cent of the consolidated pool is assigned to the county government. The rest is assigned to the local governments within the county. Of this amount, 15 percent is allocated to capital works. (The allocation is determined by the county council and is used primarily to provide counterpart financing for externally financed projects.) The remaining 85 percent is allocated among the local governments in the county through an iterative, three stage process.

1.23 In the first step, half of the money is distributed to municipalities whose PIT revenues per capita are less than half the county average. Seventy percent of this amount is distributed on the basis of population and 30 percent on the basis of built-up area. No local government, at this stage, receives more than the amount that would be sufficient to bring its per capita PIT revenues up to the county average. Any excess is added to the remaining 50 percent of the first stage pool and distributed among local governments whose per capita PIT revenues fall between 50 percent and 100 percent of the county average (including local governments that have achieved this status by virtue of transfers received in the first iteration). This pool is then distributed among the eligible local governments, again on the basis of population (70 percent) and built-up area. The amount of the transfer is again capped at the level required to bring the jurisdiction up to the county average. Funds remaining from the second iteration are subject to a third iteration, for which all local government are eligible. Funds are distributed, this time, on the basis of populated-weighted fiscal gaps—i.e., the same system used to distribute the original lump sum among counties. This exhausts all funds. There is, nevertheless, a final step in the allocation process. In order to encourage local revenue mobilization, Article 33, paragraph 4(h) provides that equalization transfers will be reduced for any local government reporting a decline in revenue from local taxes, fees, rents and dues. For each lei that revenues from these sources declines, a lei of equalization transfers is deducted. These deductions, if any, are pooled at the county level and added to the funds to be used for counterpart financing for externally financed projects.

Is the transfer system sufficiently transparent and predictable?

1.24 A long-standing critique of the Romanian transfer system has been its lack of transparency and predictability. This issue is not unique to Romania. One of the principal challenges facing all the post-Socialist counties of Europe was to devise a system for financing local government that would be perceived as fair and stable. The emergence of multi-party democracy required transparency in order to allay charges of partisan

favoritism and reduce the transaction costs that would result from continued reliance on bargaining. Predictability was required to provide local governments with a stable basis for budget planning.

1.25 The new Romanian transfer system largely meets this test. The share of the PIT to be used for equalization is fixed in law (22 percent), as is the basis on which it is to be distributed among the counties (derivation). The formula for distributing each county's consolidated pool among individual local governments is also largely fixed in law. (The only exception is the 11.25 percent (15 percent x 75 percent) reserved for counterpart funding.) While the multi-stage system used to distribute the consolidated pool among local governments is extremely complicated, it is based on a small number of readily measured variables (population, PIT revenues, land area, and built-up area) and is entirely mechanical. In principle, there is no room for discretion in the calculation of each jurisdiction's share.

1.26 The only major source of uncertainty in the transfer system is the amount of the lump sum. As noted earlier, this is subject to annual budget negotiations. To address this problem, the Government could consider enshrining the rules governing the determination of the lump sum in a more permanent form of legislation, such as the law on local public finances. Such legislation could establish a mechanism for determining the overall amount of the transfer each year—as a fixed share of aggregate national tax revenue, for example. Although some of the recent EU accession countries tie the level of transfers to a single tax—usually the PIT—this leaves local governments hostage to the vagaries of a single tax base as well as the legislation governing it. To provide for flexibility, these provisions could be subject to periodic review at, say, five year intervals, by a high level group including representatives of the relevant ministries at the central level (including the Ministry of Finance) and the associations of local governments.

Is the transfer system sufficiently equalizing?

1.27 A second critique of the transfer system is that it is insufficiently equalizing. The transfer system at present has two somewhat contradictory components. The origin-based portion of the PIT essentially returns money to where it was collected. This results in substantial disparities among jurisdictions. The equalization system then reduces those disparities. It does so in several ways. First, 70 percent of the lump sum is distributed among counties according to fiscal capacity. This favors counties with weak tax bases. The remaining 30 percent is distributed on the basis of land area. This favors rural (and presumably poorer) counties. Third, the three-stage process used to allocate the municipal share in each county favors jurisdictions with below-average per capita PIT revenues. Still and all, the system leaves 47 percent of the PIT to be distributed on the basis of origin, as well as 100 percent of collections from property taxes, fees and other local revenues. Moreover, the 22 percent of the PIT reserved for equalization is first allocated to individual counties on the basis of origin. As a result, even this component of the transfer system begins by favoring counties with strong tax bases, or more precisely, municipalities in counties with strong tax bases.

1.28 Should the government try to increase the level of equalization?[13] The case for further equalization would be compelling if local governments relied on transfers to finance functions with important distributional implications, such as teachers' salaries, social assistance, or the operating costs of primary health clinics. One could argue that all Romanians have the right to a basic level of education, health care and income security. But in Romania, such expenditures are largely financed by the central government, either in the form of earmarked transfers (such as the transfer for teachers' salaries) or through direct payments to facilities (as is largely the case for primary health). Any increase in the redistributive element of the transfer formula would instead redistribute funding that is largely used for community services and top-up to central government expenditures.

1.29 Several smaller changes could nevertheless be considered. First, the definition of the origin of PIT revenue could be changed from place-of-work to place-of- residence. People commuting across jurisdictions to work presumably use more local public services in the place where they live than in the place where work. Garbage collection, street cleaning, and parks are all primarily residential services. Existing tax data may not permit this refinement, however, if payroll records do not show the place of residence of individual workers. Data permitting, however, this reform bears consideration.

1.30 Second, the tax collection incentive could be removed from the equalization transfer. As presently formulated, this incentive merely punishes local governments that are experiencing absolute declines in own source revenues. It does not distinguish declines due to local economic conditions--which are beyond the control of the local government--from declines due to lax tax administration or deliberate reductions in tax rates. A system that responds to a jurisdiction with a declining economy by cutting its transfers is difficult to justify. If the aim of this incentive is to encourage local tax effort--a questionable aim in itself--the Government would need an uniform measure of the tax base of each jurisdiction. This does not exist. Nor is it likely to exist in the future, since each jurisdiction is responsible for its own tax administration..

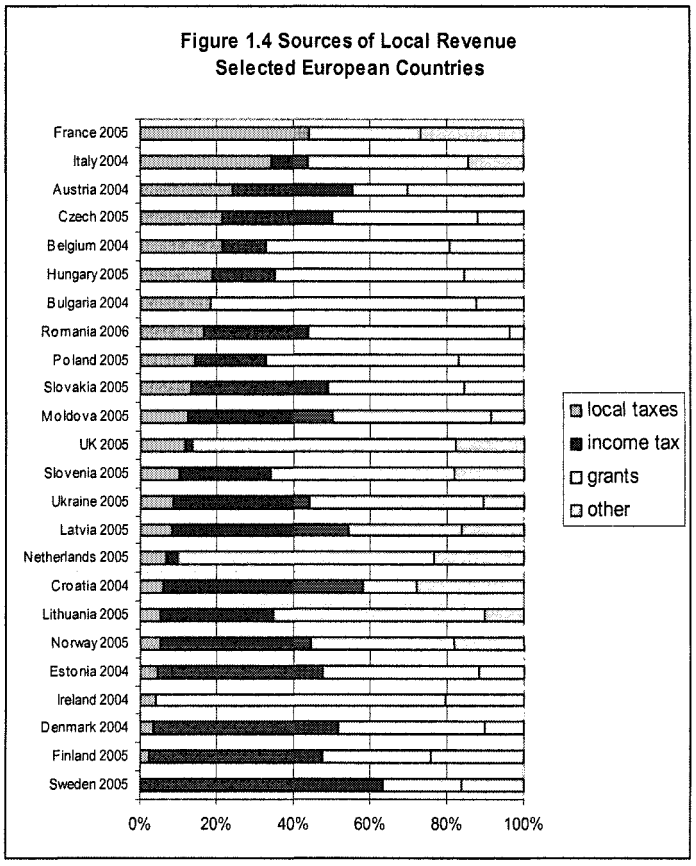
1.31 Third, the PIT component of the equalization fund could be pooled at the national level, rather than first being transferred to each county on the basis of origin. This would reduce the rather arbitrary disparities among local governments in different counties.

1.32 Finally, the Government could consider simplifying the process for distributing the equalization pool among municipalities. The present system goes to great pains to ensure that no municipality receiving equalization transfers emerges with a level of per capita revenues higher than the national average. Much the same effect could be achieved by collapsing the three-stage process into a single one: calculating the total size of the revenue gap (as the amount that would be required to bring the per capita PIT revenues of all local governments up to the national average) and pro-rating the amount of the distributable pool among them in proportion to their share of the gap. As long as the size of the pool is less than the aggregate gap, no jurisdiction receiving transfers would emerge with more than

[13] In the absence of data for 2007, it is difficult to determine how wide the disparities resulting from the new system actually are. Calculations based on the former system show that the equalization transfers did dramatically reduce variations among jurisdictions. In 2005, the coefficient of variation in local per capita revenues (including local taxes and fees and the origin-based portion of the PIT) was 1.49 (excluding Bucharest). The equalization transfer reduced this figure to 0.67.

the average level of per capita revenues. An even simpler approach could be considered.. The entire PIT—including the 47 percent distributed to local governments based on origin—could be allocated to the equalization pool and then distributed among all jurisdictions on a per capita basis.

1.33 A recent review of transfer reform options for Romania[14] suggested several other refinements. One would be to add more factors to reflect variations in 'need'. This should probably be avoided. As the report itself illustrates, variations in need are extremely difficult to determine—particularly for the sort of services provided by local governments. How much is needed to subsidize water companies (particularly when the alternative of raising tariffs exists)? How much is need to finance discretionary top-ups of central government expenditures? In effect, the current system uses population, and to a smaller extent, land area and built-up area, to measure need. In the absence of any major redistribution functions to be financed from discretionary revenues, this appears sufficient.



Are local governments too transfer dependent?

1.34 Nearly 80 percent of subnational government revenues are derived from transfers, including earmarked grants, shared transfers and equalization grants. Even leaving aside earmarked grants for education, the figure remains over 70 percent. Counties and communes are most dependent on transfers, with own revenue sources contributing as little as 8.5 percent and 16.6 percent, respectively, to their budgets. Even municipalities barely manage to finance one fourth of their expenditures through own source revenues. It has been argued that counties and local governments are excessively reliant on intergovernmental transfers. Critics have charged that transfer reliance undermines local accountability by severing the tie between taxes paid and services received. There is little empirical evidence for this assertion, however.

1.35 Moreover, practice suggests otherwise. As shown in Figure 1.4, the level of reliance on local taxes, including personal income taxes distributed on the basis of origin,

[14] Martinez-Vazquez, Jorge, et.al. December 2006. *Equalization Transfers in Romania: Current System and Proposals for Reform* Georgia State University

is not unusually low by European standards.[15] This suggests, at least, that similarly situated countries have found the benefits of relying on transfers—which include the ability to redistribute resources among jurisdictions and to minimize the costs of tax administration—to outweigh the costs, if any of doing so.

1.36 There is a persuasive case for assigning local governments a relatively broad based tax which they can use to increase (or decrease) revenues on the margin. This can provide them with a means to respond to local demands for increased spending without resorting to ad hoc assistance from the central government. But Romania already has such an instrument, in the form of the property tax. As local governments directly administer the tax and have considerable latitude over the rate, this is sufficient to provide the required degree of local revenue flexibility.

[15] Figures for 'local taxes' in Romania includes fees and charges that are classified under 'other revenues' for the other countries shown on the table.

2. LOCAL UTILITIES

2.1 Municipalities provide a variety of infrastructure services, including water and wastewater services, transportation, district heating, and solid waste management. These services are provided either by a department within a municipality or through utilities that are commercial in nature—most of which are public although there are a few private entities as well. The operations of these utilities are largely financed through tariffs and fees, rather than taxes. Their investments are supported through the internal cash generation, funds from the municipalities in some cases, and through borrowing. This section briefly examines the provision and financing of one such sector--water and wastewater services. This sector, along with solid waste management, has assumed particular prominence in the context of EU accession, as Romania has undertaken obligations for their upgrading under the environmental acquis, obligations estimated to require investment of about € 9.7 billion between 2005 and the end of the compliance period for the various sectors (2015 for water, 2017 for solid waste and 2018 for wastewater)[16].

2.2 Water and wastewater services are provided by some 950 regional and local utility companies. These utilities, run by commercially-oriented operators, have concession or service contracts with either the County Council or the Local Council. Most operate within the municipal structure, although 74 are now independent corporate entities and a few, notably the Bucharest and Ploesti concessions, have foreign private management.

2.3 Whether public or private, the utilities function under the oversight of the regulatory agency for local public services, Autoritatea Nationala de Reglementare pentru Servicii Publice de Gospodarie (ANRSC), which covers all services except water and wastewater in Bucharest.[17] The ANRSC mandate includes services related to water, wastewater, solid waste management, district heating, and urban lighting, and includes:

a) Providing licenses to operators and supervising the procurement process to select operators;

b) Endorsing and/or approving the prices and tariffs for public services; and

c) Establishing criteria and minimum performance indicators regarding the quality of public services under its jurisdiction, in line with the EU requirements.

2.4 The ANRSC, founded in 2002, became functional in 2003 and has slowly expanded the scope of its operations across its sectors of responsibility. At present it has registered some 60 water and wastewater utilities. Government is encouraging consolidation of the water industry, with a goal of reducing the current 950 to 40-50

[16] The Romanian Water Association reports the EU compliance (water plus wastewater) total at €15.1 billion.
[17] For Bucharest, the concession contract established a separate body, the Bucharest Regulatory Agency for Water Supply and Sewerage (ARBAC).

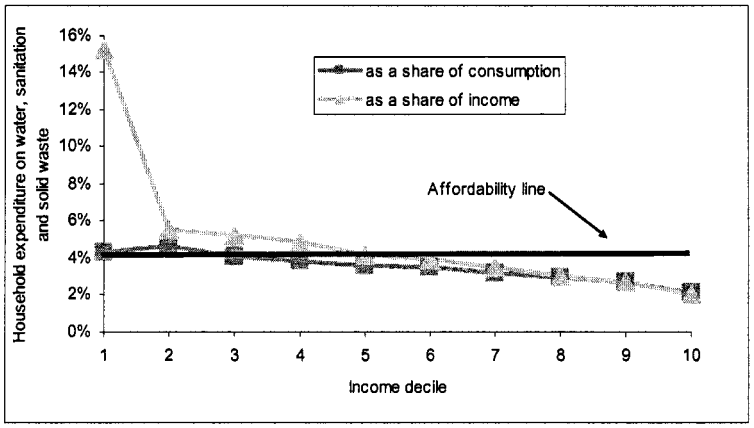
regional operators by 2015, a move that could make it much more manageable for the ANRSC to cover the universe of water utilities.

2.5 A new legal and regulatory framework for public utilities was adopted by Parliament in 2006 and will come into force on March, 21, 2007. This consists of Law 51/2006 on community services in public utilities (promulgated in March 2006), Law 241/2006 on drinking water and sewerage services (promulgated in June 2006) and Law 325/2006 on district heating services (promulgated in July 2006).

RAISING TARIFFS

2.6 Law 51/2006 establishes the legal and institutional framework, and the objectives, competences and specific instruments for the set-up, organization, management, financing and monitoring of community services in public utilities. The Law stipulates that the prices and tariffs for community services provided by operators are established based on the methodology elaborated by ANSRC. The tariffs cover operations, maintenance and repair costs, assets depreciation costs, environment protection costs, financial costs associated with contracted loans, fees for management contracts, a quota for the development and modernization of networks, and a quota for profits.

Figure 2.1 Household expenditures on water, sanitation and solid waste, as a share of household income and consumption, 2004



Source: World Bank staff estimates based on 2004 Family Budget Survey. Figures represent median by decile, and include total expenditure on water, sanitation and solid waste, not payment to utilities alone (if any).

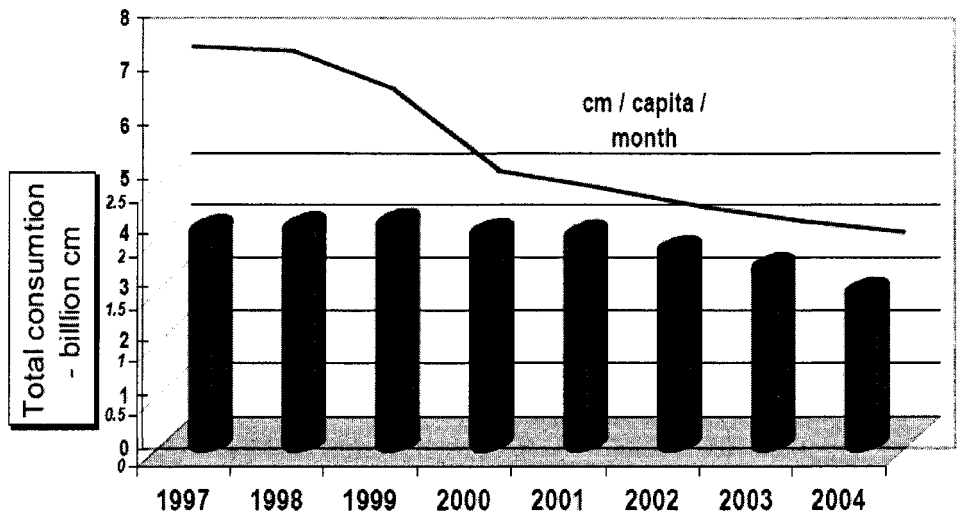
2.7 Law 241/2006 on drinking water and sewerage services indicates that the tariff for these services is to be established in accordance with the provisions of Law 51/2006. In the application of Law 241/2006, the ANSRC published for consultation a Draft Norm describing the methodology for establishing and modifying the tariffs for water and sewerage services. The Draft Norm identifies each cost component to be included in the tariff as described above. It establishes a quota of 10 percent on profits for municipal water utility companies. The Norm will come into force on the same date as the above Laws.

2.8 Romania does not have a unified database of tariff or operational information on the water and wastewater sector. From the partial information available, tariffs vary

widely, with those for water supply ranging from €0.15 to €0.55 per cubic meter and wastewater from €0.18 to €0.45 per cubic meter.[18] A separate source reports on average revenue per cubic meter of water sold, indicating that it stands at about $0.36.[19] Family Budget Survey data indicate the stress level placed on households by sector expenditures.

2.9 These tariff levels, combined with a growing metering level, have encouraged increased water consumption efficiency, both overall and within the household sector. At an aggregate level, water consumption has declined reflecting substantial decreases in per capita consumption. These results are consistent with another report that per capita consumption averages 146 lpcd outside of Bucharest.

Figure 2.2 Water consumption in Romania, total and per capita, 1997-2004



Source: Romanian Water Association at http://www.ifat.de/frontend/media/vortraege_cashflow/montag/water_supply_and_sewerage_systems_in_romania.pdf

2.10 Evidence of impressive gains in consumption efficiency is matched with the very partial results on operational efficiency.[20] These show, for example, that the number of staff per connection has fallen from 14.6 in 2000 to just over 3 in 2005. The same source reports an average operating cost ratio of 1.32 in 2005, consistent with the ability to deliver sustainable service at the current level, although not answering the question of financing the additional investment and attendant operating costs required with EU accession. In 2004, the Romanian Water Association reports that tariff revenue of €357 million covered approximately two-thirds of the combined operating and investment costs of the systems.[21]

[18] https://www.uktradeinvest.gov.uk/ukti/ShowDoc/BEA+Repository/345/387926

[19] http://www.ib-net.org/index.php. Note that revenue is an actual collection figure, not a tariff. The universe of reporting utilities may differ between the two measures.

[20] http://www.ib-net.org/index.php

[21] http://www.ifat.de/frontend/media/vortraege_cashflow/montag/water_supply_and_sewerage_systems_in_romania.pdf

2.11 Given the estimated magnitude of investments needed to comply with acquis undertakings and the level of current tariff revenues, financing EU obligations presents a substantial challenge for Romania. In 2004, with relatively low tariffs, median expenditures on water, sanitation and solid waste were 4.7 percent of household income amongst the first decile, and around 4 percent among the second, third and fourth deciles. This suggests that even relatively modest increases in tariffs could be problematic for the poorest 40 percent of the population unless compensatory measures are designed. The Government Strategy states that "tariff increases for the service should be limited to general affordability levels, and at the same time[...] reduce consumption" (Government of Romania, undated, p. 13). The Government's Strategy defines the affordability ceiling at 3.5 percent of household income for water and sanitation and an additional 1 percent for solid waste services.

2.12 Reconciling increases in municipal water tariffs that are required by the provisions of Laws 51/2006, 241/2006 and the associated ANSRC Norm with the affordability ceilings defined under the Government Strategy will require significant improvements in the social protection mechanisms for lower income groups. In particular, it is advisable for the Government to carefully assess the benefits and costs of alternative approaches to ensure the affordability of water and wastewater services for low-income households. This could include extending the existing social protection system in effect in the district heating sector to cover water and wastewater services, or designing and implementing a targeted Output-Based Aid (OBA) scheme across all sectors based on international experience.

FINANCING COMPLIANCE WITH EU DIRECTIVES

2.13 The EU Cohesion and Structural Funds will be the main external financing source for the envisaged municipal investments. Romania has finalized its Sector Operational Program for the environmental sector which lays out the country's plan to meet its EU commitment and covers the period 2007-2013. This estimates a total cost for the period of €4.9 billion (Table 2.1). Romania is now preparing more detailed implementation plans for the SOP.

Table 2.1 Draft Environmental Sector Operational Program: Cost and Financing (€ million)

Year	Cost	Financing Plan			
		Structural Funds	Cohesion Funds	Local Government	Central Government
2007	424.26	100.00	248.00	19.21	57.05
2008	616.10	133.00	376.00	28.81	78.30
2009	851.40	191.00	508.00	40.57	111.83
2010	932.43	231.00	528.00	45.12	128.31
2011	865.66	271.00	416.00	41.78	136.88
2012	610.37	197.00	284.00	30.02	99.35
2013	605.66	197.00	280.00	29.78	98.88
TOTAL	**4905.88**	**1,320.00**	**2,640.00**	**235.29**	**710.59**

Source: World Bank 2006.

2.14 The indicative financing plan presented above relies on a substantial increase on central government contributions. A substantial share of the financing requirements for the environmental SOP will also have to be met at the local level. However, local governments must respond to a much broader set of budget demands than simply water systems and the Government's Strategy for Streamlining the Development of Community Public Utility Services recommends that no more than half of the 20 percent limit (i.e. 10 percent) of public debt service be allocated to community public utilities. Consequently, a substantial portion of SOP financing requirements will need to be mobilized by local utility companies themselves.

2.15 This in turn requires that local utility companies continue ongoing efforts to improve operational efficiency, and that local governments raise municipal water tariffs to cover the cost of equity and debt financing of local utility companies' investments in line with the provisions of Laws 51/2006 and 241/2006 and associated ANSRC Norm.

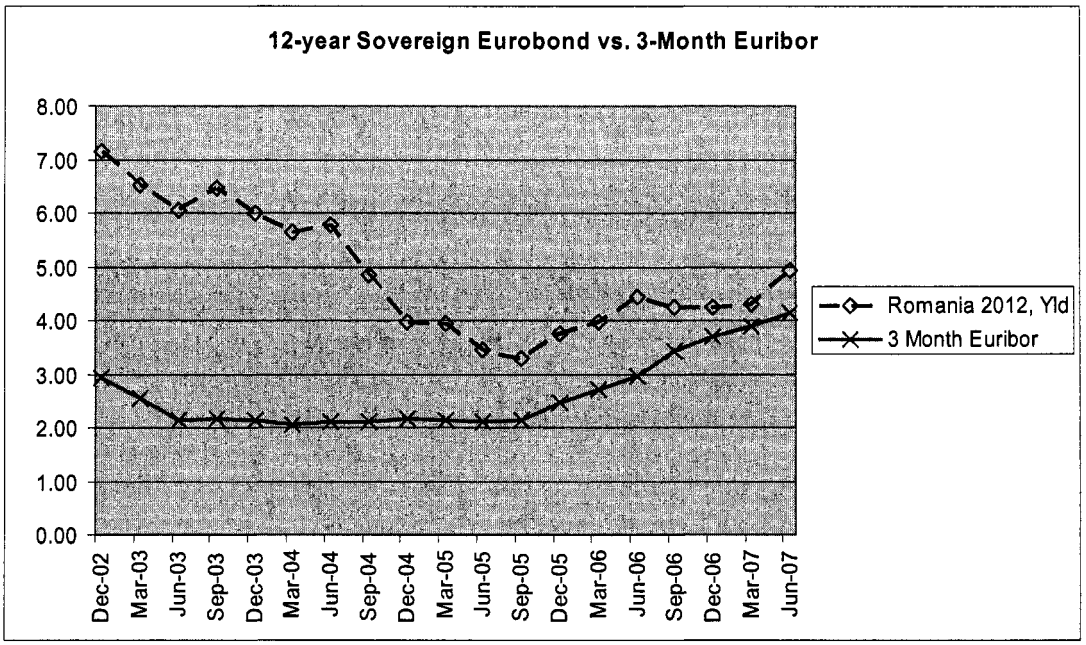
2.16 At the municipal level, tariffs can be augmented by additional revenue sources, including a Development Fee, a Contract Fee, a Municipal Repair and Development (MRD) Fund, or the Local or County budget. However, the fees and Fund generate their revenue from the same set of consumers under tariff stress, limiting their application.

2.17 In sum, there are fairly good estimates of the investments needed for Romania to comply with the EU directives. However, financing these investments poses a substantial challenge for the authorities: public resources are limited by tight budget constraints, commercial financing is not easily available for many municipalities due to their lack of creditworthiness, and many local utility companies have difficulties securing commercial financing because existing tariffs do not cover the equity and debt financing cost of their investments, in particular in the water and wastewater sector. The gap between currently available resources and the total financing demands in the water and wastewater sector highlights the urgent need for the Government to establish conditions that will enable sub-national entities to finance their infrastructure investments on the sub-national debt market.

3. THE MUNICIPAL DEBT MARKET IN ROMANIA

3.1 Spurred by monetary and fiscal stabilization and rising expectations of EU convergence, the Romanian financial market has developed very rapidly over the last five years. The spread between the 12-year sovereign Eurobond and the 3 month Euribor declined from 420 basis points in December 2002 to 80 basis points in June 2007 (see Figure 3.1). Romania's sovereign credit rating reached investment grade in September 2005 (Standard & Poor's BBB – (stable)(foreign currency); BBB (stable)(domestic currency). Since then, Fitch upgraded Romania's long-term foreign currency Issuer Default Rating (IDR) to BBB in August 2006 and Moody's upgraded the country's foreign currency government bond rating to Baa3 in December 2006 in line with the country's EU accession.

Figure 3.1: Sovereign Eurobond-Euribor spread, 2002 - June 2007

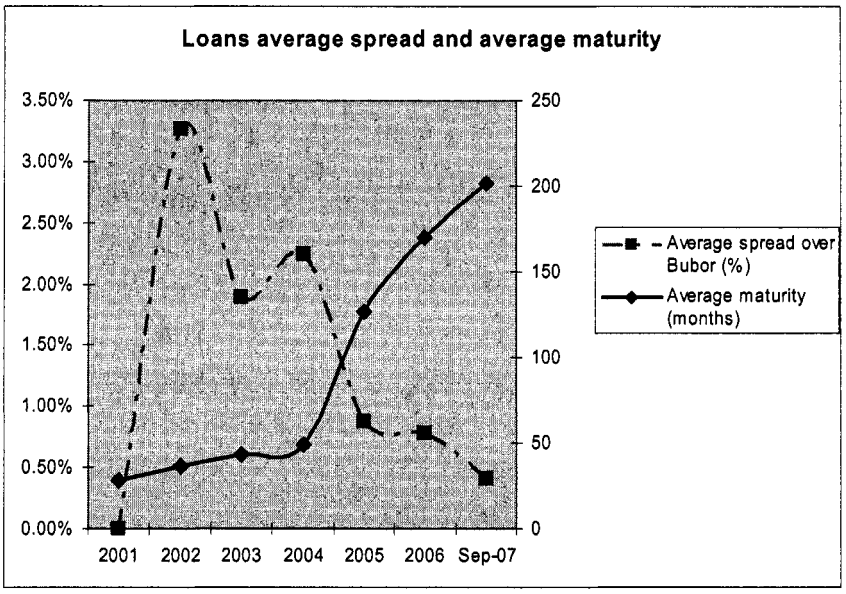


Source: MEF

3.2 In this favorable context, the local government debt market has taken off rapidly, although from a very low base. Domestic currency loans by commercial banks to local governments increased from RON 3.6 million in 2001 to RON 1,399 million in 2006 (or US$ 498 million). They amounted to RON 704.7 million in the first 9 months of 2007 (or US$ 287 million) (See Statistical Annex Table A1). Short-term loans (maturity less than 1 year) grew from RON 1.8 million in 2001 to RON 16.9 million in 2005, or 1.2 percent of the total. Loans with maturity longer than 1 year increased from RON 1.8 million to RON 1,393.4 million over the same interval, or 98.8 percent of the total. Among loans with maturity longer than 1 year, average maturity increased from 2.3 years in 2001 to 4.1 years in 2004, to 10.6 years in 2005, to 14.2 years in 2006 and to 16.8 years in the first 9 months

of 2007. The longest maturity was 3 years in 2001, 10 years in 2004, and 25 years starting 2005. Among loans with maturity of less than 1 year, average spreads over BUBOR declined from 500 basis points in 2002 to 195 basis points in 2004. Among loans with maturity longer than 1 year, average spreads over BUBOR declined from 327 basis points in 2002 to 224 basis points in 2004, to 78 basis points in 2006 and to 41 basis points in the first nine months of 2007 (See Figure 3.2). The reduction in spreads was accompanied by significant spread compression across all local government categories, with spread variation dropping from 196 basis points in 2003 to 58 basis points in 2006 and 58 basis points in the first nine months of 2007.

Figure 3.2: Local government loans average spread and maturity, 2001-September 2007



Source: MEF

3.3 Domestic currency bonds issuance by local governments increased from RON 2.3 mln in 2001 to RON 46.5 in 2003, declining to RON 36.7 mln in 2004 (or US$ 11.2 mln). It amounted to RON 38.8 mln in 2005 (or US$ 12.9 mln) and RON 133.0 mln in the first nine months of 2007 (or US$ 40.3 mln) (See Statistical Annex Table A2). Average size of bond issues was RON 6.5 Mln in 2005; it amounted to RON 22.1 mln in the first nine months of 2007. Average maturity increased from 2.5 years in 2001 to 3.3 years in 2004, 6.7 years in 2005, 16.5 years in 2006 and to 19 years in the firs nine months of 2007. The longest maturity was 3.5 years in 2001, 6 years in 2004 and 20 years in 2005, 2006 and the first nine months of 2007. Average spreads over Bubor were negative until 2003. The average spread over Bubor was 69 bp in 2004, declining to 32 bps in 2005 and increasing to 76 bps in 2006. In the first nine months of 2007 the average spread over Bubor was 11 bps.

3.4 Over the period 2001-September 2007, 15 municipalities larger than 100,000 inhabitants (about 62 percent of the group) and 47 municipalities between 13,000 and

100,000 inhabitants (about 63 percent of the group) had access to loans/bonds. By contrast, only about 14.5 percent of towns and communes (with less than 13,000 inhabitants) had access to loans/bonds. 22 County Councils (or about 52 percent of the group) had accessed the loans/bonds market.

3.5 The geographical distribution of municipal loans has been spreading progressively toward medium-size cities and, to a lesser extent, small cities and communes. In 2005, the geographical distribution of domestic currency loans with maturity longer than 1 year was 41.4 percent to Bucharest, 41.8 percent to municipalities larger than 100,000 inhabitants (including County Councils), 11.3 percent to municipalities smaller than 100,000 inhabitants, and 5.5 percent to small cities and communes. In 2006 the geographical distribution of domestic currency loans with maturity longer than 1 year was 22.2 percent to Bucharest, 53 percent to municipalities larger than 100,000 inhabitants (including County Councils), 15.5 percent to municipalities smaller than 100,000 inhabitants, and 9.3 percent to small cities and communes. In the first nine months of 2007 the geographical distribution of domestic currency loans with maturity longer than 1 year was 69.5 percent to municipalities larger than 100,000 inhabitants (including County Councils), 21.2 percent to municipalities smaller than 100,000 inhabitants, and 9.3 percent to small cities and communes.

3.6 In 2005, the geographical distribution of domestic currency bond issuance was 52 percent for municipalities larger than 100,000 inhabitants (including County Councils), 37 percent for municipalities smaller than 100,000 inhabitants, and 11 percent for cities and communes. In the first nine months of 2007 the distribution was 94 percent for municipalities larger than 100K inhabitants (including County Councils) and 6 percent for municipalities smaller than 100K inhabitants.

3.7 Borrowing by local utility companies on the domestic market has been insignificant to date. Over the past 6 years, IFIs and foreign commercial banks lent to Romanian municipalities at the rate of Euro 150 million a year, with an average loan size of Euro 14 million. Average loan maturities ranged from 13 to 25 years over the period. Spreads over Euribor average was ranging from 35 basis points to 398 basis points. External lending was highly concentrated on Bucharest and on cities larger than 100,000 inhabitants, which received more than 88 percent of external loan value to local governments over the period (See Technical Annex Table A3).

3.8 In May 2005, the municipality of Bucharest obtained an S&P rating of BB in both foreign and domestic currency. In May 2005, the city's rating was upgraded to BB+ (stable) in foreign and domestic currency, i.e. one notch below the sovereign for foreign currency rating, and two notches below the sovereign for domestic currency rating (see above). In June 2005, Bucharest placed a fixed coupon Eurobond with a spread at issuance of 216 basis points above Euribor with a 10 year maturity.

3.9 The spread compression observed on the domestic local government debt market over the last two years has been driven by several, mutually reinforcing factors. First, excess liquidity in the domestic banking system, conservatively estimated by market participants at Euro 5-6 billion in 2005. Second, the pricing behavior of the (then State-

owned) BCR as the dominant market player. And third, distortions in risk pricing resulting from deficiencies in the legal and regulatory framework for local government borrowing (see Section 3.2 below). Some of these factors are already changing. Starting in November 2005, NBR introduced measures to sterilize excess liquidity in the domestic banking sector. Excess liquidity in the domestic banking sector was drained largely via variable-rate deposit auctions and also through issuance of certificates of deposit. The stock – daily average – of both deposits taken and certificates of deposit issued by NBR have declined from about Euro 3.3 billion in 2006 to about Euro 2.8 billion by September 2007 and average spreads on the domestic local government debt market started to widen in 2006. And the privatization of BCR in October 2006 resulted in the emergence of a sub-national debt market largely dominated by private players.

3.10 The recent entry of Romania into the EU single financial market creates both opportunities and challenges for the future development of the sub-national debt market. On the one hand, as experienced by the recent EU accession countries of Central Europe, competition in the market will continue to increase as European and international banks and institutional investors increase their exposure to the Romanian market, both through expansion of activities of subsidiaries and branches already present at the time of accession and through new entry. This will further diversify the range of financial products available for Romanian sub-national entities and may put further downward pressure on spreads. On the other hand, Romanian sub-national entities, both local governments and municipal corporations, will face increased competition from similar entities in all EU-27 member countries to secure a share of bank lending and institutional investor investments in the context of international risk management strategies that are conceived and deployed at the level of the EU single market. These opportunities and challenges will further intensify as a result of the entry into force of the Markets in Financial Instruments Directive (MiFID) on November 1, 2007 and as a result of Romania's future entry into the Euro-zone. Meeting them will be crucial for Romanian sub-national entities to be able to mobilize the financial resources required to improve local service delivery for the population and to meet the standards of the acquis communitaire in the context of the EU single market.

3.11 To seize these opportunities and meet these challenges, the Government needs to focus on two main priorities. First, to develop and implement a modern legal and regulatory framework for local government borrowing that removes distortions in risk pricing on the market and allows the emergence of a level and transparent playing field on which Romanian sub-national entities can compete for bank and institutional investor portfolio allocations in the context of the EU single market. And second, to design and implement a coherent strategy to increase the access of sub-national entities to the sub-national debt market in function of their risk profile.

REFORMING THE SUB-NATIONAL DEBT MARKET LEGAL AND REGULATORY FRAMEWORK

3.12 The legal and regulatory framework for local government borrowing suffers from several deficiencies pertaining to (i) control of local government borrowing; (ii) local government own-revenue guarantees; (iii) short-term Treasury loans; (iv) local government bankruptcy; (v) risk fund for local governments; (vi) risk-weighting for local government

debt in the calculation of banks capital adequacy ratio; and (vii) enforcement of public procurement law on access to bank borrowing. In addition, the development of the market is hampered by the high regulatory cost of bond issuance. Addressing these deficiencies constitutes the first priority for the Government to enable the development of the sub-national debt market in the context of the EU single market.

Control of local government borrowing

3.13 Under Law 273/2006 on Local Public Finance (LLPF), control of local government borrowing consists of two components: (i) ex ante authorization of local government borrowing and guarantees by the MEF on a case by case basis; and (ii) a prudential limit on the local government debt service set at 30 percent of own revenues[22]. In addition, the MEF may issue case-by-case derogations from the debt service ceiling through Emergency Ordinances. The City of Bucharest obtained such derogation for the issuance of its Eurobond in June 2005 through Emergency Ordinance 225/2005, approved by Law 44/2005.

3.14 Under Government decision 9/2007 establishing the Local Borrowing Authorization Commission, the application package to be submitted by local governments to the Commission includes, in addition to basic information on the borrowing decision by the local government, the loan or guarantee agreement and current and past budget execution, detailed financial scenarios of the local government debt service during the period of the loan/guarantee. This de facto places the MEF in the position of assessing the creditworthiness of local governments for each new borrowing or guarantee, a function which should be left to private banks, bond underwriters and credit rating agencies in the context of a market economy.

3.15 By placing the MEF in the position of assessing the creditworthiness of local governments for each new borrowing or guarantee, the LLPF puts unnecessary political pressure on the MEF to bail-out a local government in case of default on a debt obligation that it has itself approved (i.e. implicit guarantee), thereby generating moral hazard. This is further magnified by the MEF's authority to issue case-by-case derogations to debt service ceilings for local governments. To remove this major source of moral hazard, it is advisable to gradually phase-out MEF ex ante control of local government borrowing and replace centralized screening of local government creditworthiness by market discipline, in tandem with the introduction of the local government bankruptcy framework and with the phasing-out of Treasury loans (see below):

3.16 During a first phase, (Phase One), the authorization for local government borrowing by the MEF would be automatic unless the MEF formally notifies the local government of its decision to deny the authorization within 15 working days of the date of submission of the dossier of registration. The dossier of registration would be simplified and contain information on the local government decision to borrow, the loan agreement or bond prospectus, and current and past budget execution. The LLPF would indicate that the MEF

[22] The loans contracted/guaranteed by the local authorities to pre-finance and/or co-finance projects which benefit of non-reimbursable pre-accession and post-accession EU funds are exempted from this provision (Emergency Ordinance 46/June 2007).

decision to deny authorization is based solely on material flaws in the registration dossier or its failure to satisfy the prudential limit on the local government debt service and would be published on the MEF website upon its communication to the local government. The LLPF would also indicate that the local government has the right to appeal this decision. Transparent procedures for appeal of the decision would be spelled out in a separate regulation, including the modalities for publication of the request for appeal and of the appeal decision on the MEF's website. The LLPF would also explicitly prohibit case-by-case derogations of debt service ceilings for local governments by the MEF.

3.17 During a second phase (Phase Two), the authorization of local government borrowing by the MEF would be entirely automatic. The MEF would exercise ex post control of local government borrowing through a quarterly budget execution review process. If a local government exceeds its debt service limit, the MEF would issue a decision prohibiting any new net borrowing by the local government until its budget is brought back into compliance with the prudential ratio.

3.18 During a third phase (Phase Three), MEF control would be exercised ex post through the regular yearly budget execution review process. As in Phase Two, if a local government exceeds its debt service limit, the MEF would issue a decision prohibiting any new net borrowing by the local government until its budget is brought back into compliance with the prudential ceiling.

3.19 In the longer-term, at the latest by the time of integration into the Euro-zone, local governments that have obtained at least two global scale, local currency credit ratings by established international rating agencies would be subject to more a relaxed debt service limit, giving market participants ample room to make lending decisions based on the local government credit quality. The MEF would continue to exercise its yearly ex post control over local governments as described in Phase Three.

3.20 In addition, it is advisable that the LLPF stipulate that that ex ante approval be required for local government borrowings in foreign currency (i.e. non-Euro following entry in the Euro-zone) and for local government borrowings or guarantees requiring Government sovereign guarantee or counter-guarantee.

Local government own-revenue guarantees

3.21 Article 63 of the LLPF allows local government debt to be guaranteed by its own revenue—including Government transfers --and gives precedence to such debt over all other claims against the local government[23]. Some financial institutions consider that the own-revenue guarantee issued by a local government is exercisable with the Treasury. Therefore they consider this guarantee as good as a government guarantee and explicitly

[23] Art. 63 reads: "(1) The loans contracted by the administrative-territorial units, as well as those contracted by the companies and public services under their subordination, may be *guaranteed with their own revenues* as defined in art. 5, paragraph (1), letter a); (2) Any guarantee with revenues shall become effective on the date the guarantee is granted; the revenues securing the guarantee that are collected by the local authority shall be subject to the provisions of the guarantee agreement, and *the requirements of that agreement shall be given priority over any third party request to the local public administration authority, regardless of whether or not the third party is aware of the guarantee agreement.*" Art. 5 reads: "(1) local budget revenues are be composed of: (a) own revenues from: taxes, fees, contributions, other payments, other revenues and allocated shares from the income taxes; (b) amounts allocated from certain revenues of the state budget; (c) subsidies from the state budget and from other budgets; (d) donations and sponsorships.

mention this guarantee in bond prospectuses to investors. On the other hand, Law 288/2002 stipulates that the State Treasury can only execute payments when ordered by budget managers of public institutions. This would appear to give local governments discretion to honor their guarantees or not. This ambiguity has been addressed by Law 110/2007, which stipulates (Art.3) that if a public institution fails to fulfill its payment obligations within 6 months from the date it receives an enforcement order, the creditor may request enforcement according to the Civil Procedure Code and/or other applicable legal provisions. The credit release authorities (in this case, the mayors of local governments/president of County Council) have the obligation to order all steps, including transfers of budgetary resources, necessary to ensure, both in their budgets and in the budgets of institutions under their supervision, the amounts necessary to pay the amounts set forth by the enforcement order. If the local authority fails to comply, the Treasury, acting on instructions from the court, may transfer the funds directly from the municipality's account to the creditor. It is not yet clear, however, that the market perceives the distinction between these provisions and a central government guarantee.

3.22 Further changes in legislation are under consideration. An Emergency Ordinance 64/2007[24] on Public Debt was published in the Official Gazette on June 2007. The EO 64/2007 considers establishing the general framework and principles of the public debt management dealing with the government public debt. In this context, the EO 64/2007 proposes to abrogate, among others, the Law 313/2004 on Public Debt, with subsequent amendments, and some provisions concerning offences and punishments of the Law 273/2006 on Local Public Finance. The Emergency Ordinance was rejected by the Senate in October 2007 and is now (November 2007) under discussion in the Chamber of Deputies. It is important that any new legislation in this field make it clear that local government debt—whether revenue guaranteed or not—carries no implicit Government backing.

Short-term Treasury loans

3.23 The LLPF allows the MEF to extend short-term Treasury loans to local governments. Treasury loans to local governments create three fundamental problems. First, they put the MEF in the role of credit allocation and pricing for local governments. Second, international experience with Treasury and other Government agency loan facilities or with State-owned municipal funds shows that such facilities or funds are open to political pressure, often resulting in discretionary decisions and generating a culture of non-repayment. And third, Treasury loans constitute a ready-made instrument to bail out local governments in case of default. As a result, Treasury loans soften the budget constraint for local governments and breed moral hazard on the sub-national debt market.

3.24 It is advisable to progressively phase-out the Treasury loan instrument, starting with the largest cities. These cities could use the provision of the LLPF allowing local governments to open a bank account linked with a loan from a private bank and open overdraft facilities with private banks to manage their short-term liquidity needs.

Local government bankruptcy framework

3.25 Articles 74 and 75 of the LLPF provide a sound legal framework for local government bankruptcy. A draft law (which, when promulgated, will specify the procedure in applying the provisions of Articles 74 and 75) is currently being prepared by the Ministry of Interior and Administration Reform and the Ministry of Economy and Finance. The current (2007) version of the draft law is quite comprehensive, specifying the criteria to be used in declaring a state of financial crisis and its termination, the content of financial recovery plans, the participants in the process (including the syndic judge, the creditors' committee, and the judicial administrator) and sanctions to be imposed. Certain issues remain to be clarified, however, including the definition of 'essential municipal services' and the conditions under which loans from the State Treasury would be made to local government undergoing a plan of financial or insolvency recovery. Article 93 of the current draft permits the Ministry of Finance to authorize the Treasury to make loans for the implementation of insolvency recovery plans. It also permits the Government to provide support from the Government reserve fund. Both forms of assistance should be available only under highly restricted conditions, in order the appearance of a Government bailout and the moral hazard this would create.

Risk fund for local governments

3.26 The LLPF provides for the establishment of a Risk Fund to cover the financial risks that derive from the guarantees by local government units for loans contracted by municipal corporations. The Risk Fund is an off-budget item that contains the commissions and other fees paid by the beneficiaries of loan guarantees, and from which payments are made in case of guarantee calls. If such payments are made, the amounts recovered from the defaulted entities are used to replenish the Risk Fund. It would be advisable that the methodological norms to be issued in the application of LLPF specify the modalities of implementation of the Risk Fund by local governments, paralleling those being developed at the level of the MEF Risk Fund.

Risk weighting local government debt in calculating bank capital adequacy ratio

3.27 In setting capital adequacy ratios for loans to local governments, National Bank of Romania (NBR) regulations require banks to use a risk-weighting of 50 percent for loans to jurisdictions with no credit rating and a variable risk-weight to jurisdictions that have been rated. [25] Although this is considerably higher than the previous 20 percent risk weighting, it still signals that lending to local governments carries modest risk and therefore contributes to moral hazard in the market. Consistent with the legal and regulatory revisions proposed in this Policy Note, it would be advisable for NBR to raise the risk weight to 100 percent for loans to local governments with no credit rating. While this could increase the cost of borrowing for small jurisdictions (as they may be unable to afford a credit rating) the 100 percent weight better reflects the risk of lending to such entities, particularly as the option of bankruptcy (through the insolvency procedure described earlier) exists.

[25] Regulation NBR-NSC No. 14/19/2006 on credit risk treatment using the standardized approach, for credit institutions and investment firms

Enforcement of public procurement law on access to bank borrowing

3.28 Local government/municipal corporation access to bank borrowing is subject to the Public Procurement Law. These bodies are required to obtain a minimum of three tender offers for each loan. This procedure is sound and should be enforced without exceptions.

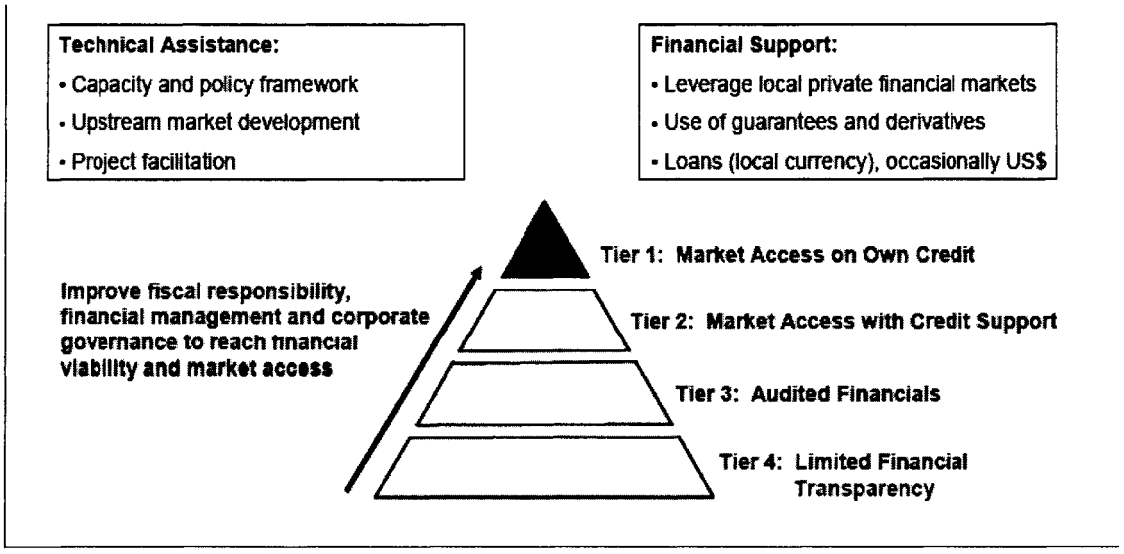
High regulatory cost of bond issuance

3.29 A key constraint cited by market participants is the high regulatory cost of bond issuance in Romania compared with the international benchmarks. For example, the cost of a €50 million bond listing on the Vienna Stock Exchange is €3,000 and the cost with the regulatory authority is €800, compared to a regulatory cost of a bond of similar size in Romania of €50,000 (0.1 percent Security Exchange Commission fee plus a maximum 0.02 percent Bucharest Stock Exchange fee when the distribution is through BSE). It would be advisable to align the regulatory costs of bond issuance in Romania with those observed in EU member countries in order to enable domestic issuers to compete on a level playing field with their EU competitors.

IMPROVING SUB-NATIONAL ENTITIES' ACCESS TO THE SUB-NATIONAL DEBT MARKET

3.30 As a second priority, the Government needs to design and implement a coherent strategy to improve access by sub-national entities, both local governments and municipal corporations, to the sub-national debt market in the context of the EU single market. This strategy should consist of a range of technical assistance and financial support instruments carefully modulated based on the risk profiles of particular sub-national entities in Romania (see Figure 3.3 below).

Figure 3.3 Technical assistance and financing instruments



Source. World Bank, Sub-national Development Program, 2006

(i) Low risk sub-national entities (Tier 1)

3.31 At the top of the pyramid are low-risk sub-national entities that can access the market on their own credit to finance their infrastructure investments, including financing the counterpart funds for EU cohesion and structural funds. In Romania, this market segment comprises a small group of about 10 to 15 large municipalities that are one or two notches below the sovereign rating, based on their credit rating by an international rating agency or on their internal risk assessment by a domestic bank(s). These municipalities can access the domestic market on their own at maturities exceeding 15 years and at spreads below 50 basis points without sovereign guarantee. These municipalities have therefore graduated from financial support from International Financial Institutions (IFIs), as the cost of credit enhancement that could be provided to them by IFIs is higher than the benefit of this enhancement in terms of spread reduction and maturity extension. In practice, some of these cities still opt to draw on IFI resources although that is expected to change over time.

(ii) Medium-risk sub-national entities (Tier 2)

3.32 Next is a second tier group consisting of sub-national entities that can still access the market but with higher spreads and shorter maturities that are not suitable for the financing of infrastructure investments. This is due to a variety of conditions affecting their risk profile, including size, own revenue base, or debt sustainability. In particular, many sub-national entities in this group may be too small to issue a bond of a size reaching the minimum threshold of liquidity on the domestic market. In Romania, this second tier group comprises the vast majority of secondary municipalities and their local utility companies, as well as a few towns and communes.

3.33 This second group could benefit from a dual package of support including both technical assistance and financial support.

Technical assistance

3.34 The package of technical assistance would aim to strengthen the fiscal and financial management as well as the quality of governance of the sub-national entities in the group with the objective to enable them to eventually join the first tier and access the market on their own credit.

3.35 This package of technical assistance could aim to:

(i) Develop the capacity of sub-national entities to prepare investment programs and projects, including thorough economic and financial appraisal and assessment of environmental and social dimensions and mitigation of their investments;

(ii) Improve the performance of local utilities, possibly through PPPs, in which case it would include developing the capacity of municipalities and municipal corporations to

structure and negotiate Public-Private Partnerships (PPPs) with private investors/operators[26];

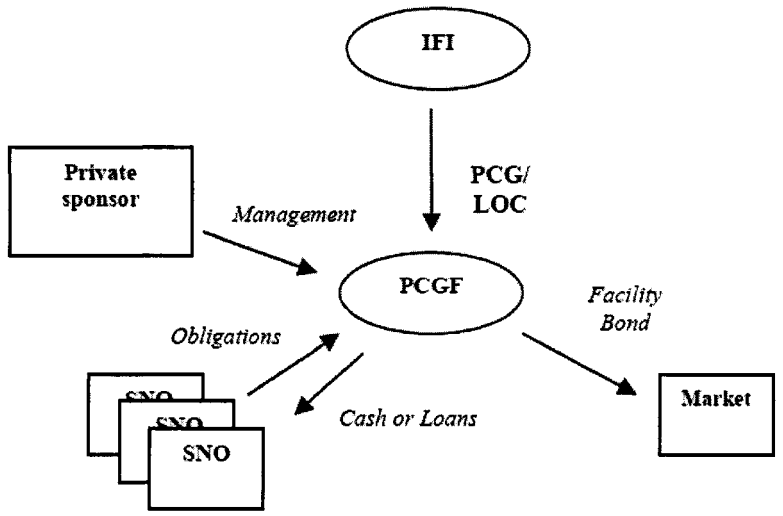
(iii) Help municipalities develop and administer social protection programs for low-income households, so as to improve their ability to raise tariffs towards cost-recovery levels in a manner that is socially and politically acceptable; and

(iv) Develop the capacity of municipalities and municipal corporations to prepare detailed dossiers for international credit rating agencies with the objective of obtaining a local or foreign currency, global scale credit rating.

Financial support

3.36 As sub-national entities in the group strengthen their fiscal and financial management capacity, including their capacity to structure financing packages for loans or bond issuance, various forms of financial support could be developed to improve their conditions of access to the market. In particular, a Partial Credit Guarantee Facility (PCGF) could be developed, taking as a model similar facilities that have been successfully implemented to develop the secondary mortgage market in several emerging market economies, for example in Colombia. The possible structure of such a Facility for sub-national debt obligations is presented in Figure 3.4 below.

Figure 3.4: Partial credit guarantee facility for sub-national debt obligations (SNOs)



[26] This component would cover the full range of PPP transactions including management contracts, leases, BOOs, BOTs, concessions and divestitures. It would apply both to traditional local utility companies, and to Municipal Services Companies (MSCs) that may be established to undertake and manage investments in other sectors, such as road maintenance and the social sectors (See Annex III.2: UK Private Finance Initiative (PFI) model).

3.37 The adoption of the Securitization Law and of related secondary legislation in 2006 provides the foundation for structuring the proposed Facility on the basis of a Special Purpose Vehicle (SPV) registered in Romania. The SPV would be established and managed by a private sponsor as a securitization company or trust with compartments. On the asset side, the SPV could hold a portfolio of municipal or municipal utility corporations' debt obligations (SNOs). These could be loans or bonds, including general obligation (GO) bonds issued by municipalities and revenue bonds issued by municipal corporations. The liabilities of the SPV could consist of senior and subordinated debt tranches and an equity tranche. The cash flows from income and principal could be distributed among the various debt tranches and the equity tranche according to pre-set rules. The SPV would be externally credit-enhanced through a partial credit guarantee for SPV bonds from an IFI. In addition, the IFI could also provide a liquidity facility to the SPV to manage cash-flow mismatches. The structure of the partial credit guarantee for SPV bonds could be defined on the basis of market demand. Each SPV would be rated by international agencies.

3.38 The structure would be strictly market-driven and sponsored by private investors. The SPV manager could build a first compartment based on available sub-national debt deal flow, portfolio diversification criteria, and investors' appetite. Subsequent compartments could have different underlying assets and portfolio risk profiles to adapt to the evolving supply of debt obligations by municipalities and municipal corporations and investors' appetites.

3.39 Access to the securitization vehicle by municipalities and municipal corporations would be subject to a number of criteria. In the case of municipalities, these would include (i) past budget performance; (ii) quality of investment program; (iii) medium-term budget scenarios/stress tests; (iv) quality of municipal governance (budget management, transparency, disclosure). In the case of municipal corporations, criteria would include: (i) quality of contractual arrangements between the municipality and the municipal corporation; (ii) quality of contractual arrangement between private investor/operator and the municipal corporation in case of PPP; (iii) past financial performance; (iv) quality of investment project; (v) medium-term financial scenarios and stress tests; and (vi) quality of governance (operational and financial management; transparency; disclosure).

3.40 A simplified financial simulation of the proposed PCGF is presented in Annex III.

High-risk municipalities/municipal corporations (Tiers 3 and 4)

3.41 High-risk municipalities and municipal corporations do not have access to the market, even with credit enhancement. Because they are not creditworthy, these municipalities and municipal corporations should not borrow from any source (including on-lending from the central Government).

3.42 For this group, support would focus essentially on technical assistance to strengthen fiscal and financial management and corporate governance, up to the point where the entities are able to produce audited financial statements. A particular emphasis would be placed on developing the capacity of small cities and communes to form Inter-Municipal

Undertaking (IMUs) (inter-communales) with the objective to reach economies of scale for the provision of local services whenever economically justified.

3.43 In parallel, conditional capital grants may be justified to fund local investments of high priority from an economic, social and/or environmental perspective, including funding the domestic counterpart of EU funds. A possible approach could be to establish a competitive capital grant system under which sub-national entities belonging to this group would compete for a limited envelope of grants based on their score across a number of access criteria. Moral hazard could be mitigated by requiring that repeat grants to the same local government or municipal corporations would be subject to a pre-set improvement in their multi-criteria score, and by limiting the number of repeat grants. As a result, high-risk local governments and municipal corporations would have a built-in incentive to improve the quality of their management across a broad range of dimensions and thereby the possibility of graduating to Tier 2 and accessing the market with external credit support.

Romania: Municipal Finance Policy Note

ANNEXES

Annex I

Annex Table 1.1 Selected County Functions			
	Policy	Financing	Service delivery
Water supply and water sewage27	Central government	Regional operator County government	County government
County roads	Central government	County government Ministry of Public Finance	County government
Transport	Central government	County government Private or public operators	Private operators and/or county government
Airports (civil airports)	Central government	County government.	County government
County public service for personal data records28	Central government	County government Central government	County government
Maintenance of public health units of county interest	Central government	County government Central government	County government De-concentrated services of central government
Special education	Central government	County government Central government	County government The de-concentrated units of the central government
Centers for children with disabilities, Services for abused and neglected children	Central government	County government The Ministry of Public Finance	County government
Care and assistance centers for persons with handicap	Central government	County government The Ministry of Public Finance	County government
Centers for recovery and psychiatric rehabilitation	Central government	County government The Ministry of Public Finance	County government
Cash benefits for blind persons and their escorts	Central government	The Ministry of Labor, Social Solidarity and Family	County government for identification of eligibility De-concentrated units of the central government for payment
Food allowance for institutionalized children with HIV/SIDA	Central government authority	County government The Ministry of Public Finance	County government
Art and Vocational School	Central government	County government Art and Vocational School	County government Art and Vocational School

[27] This function is assigned to this administrative level only when a regional operator is created and placed under the county council.

[28] The service was set up through the merger of the civil status service, already subordinated to the local government, and the county office for personal data records, previously subordinated to the Ministry of Administration and Interior.

County guard service	Central government	County government County guard service	County government
Public service	Policy function	Financing	Service delivery

Annex Table 1.2 Selected Local Government Functions			
	Policy	Financing	Service delivery
Emergency situations at the local level	Central government	Local government	Local government
Water supply and water sewage	Central government	Water Operator Local government	Local government
District heating	Central government	Local government Ministry of Public Finance The district heating operator	Local government The district heating operator
Waste management	Central government	Local government The operator of waste management service	Local government The operator of waste management service
Local public transport	Central government	Local government The operator of local public transport service	Local government The operator of local public transport service
Public lighting	Central government	Local government	Local government
Road and street network	Central government	Local government for the street network of local interest, Central government for commune and national roads	Local government for the street network of local interest, county government for commune and county roads, central government, for national roads
Housing	Central government	Local government De-concentrated units	Local government
Community public services for personal data records	Central government	Public community service for personal data record Local government Central government	Local government for the service delivery, County Council and the central government for methodological control
Community police	Central government	Local government	Local government
Social-medical assistance services	Central government	Local government, the socio-medical assistance unit, the National House of Health Insurance, Central government	Local government, the social medical assistance unit, for delivering the public service
Maintenance of public health units of local interest	Central government	Local government Ministry of Health	Local government Ministry of Health, through its de-concentrated services
Day nursery	Central government	Local government Ministry of Public Finance	Local government
Preschool education	Central Government	Local government, Central government	Local government De-concentrated services of Ministry of Education and Research

Annex Table 1.2 Selected Local Government Functions, cont'd			
Primary and secondary education	Central Government	Local government Central government	Local government, Teachers' board, the Administration Board, De-concentrated services of central government
High school (secondary) education	Central government	Local government Central government	County government and in some cases larger local government, Teachers' board and the Administration Board De-concentrated services of the central government
Shelters for the elderly	Central government	The shelter for elderly persons, Local government, The National House for Social Health Insurance	The local government Central government
Newborn child allowance	Central government	Ministry of Labour, Social Solidarity and Family	Local government
Emergency centres for the victims of domestic violence	Central government	Local government	Local government
Social aid (minimum guaranteed income)	Central government	Local government 29 Ministry of Public Finance	Local government
Cultural centre	Central government	Local government Cultural center	Local government Cultural center

[29] The sector legislation in force assigns this competence exclusively to the local government (communes and towns), but in practice 80% of the funds used for this purpose come from the state budget through allocated sums from some state budget revenues (earmarked transfers).

ANNEX II

Utility Provision and EU Financing Arrangements

Central Government Support for Environmental Investments

The nature of the water and wastewater business is such that it requires public support for investments. In financial terms, compared to the other infrastructure sectors, the investment needs in the water sector are highest to generate unit of revenue[30] (Table 1). The table below shows that it would take a much longer time to recover the investment from the annual revenue in the water supply and sewerage sector than in the other infrastructure sectors. As a result, private investors will be cautious to invest, especially if tariffs are determined in a subjective and politically driven manner.

Table 1
Return on Investments

Sector	Required Assets/Operating Revenues
Water Supply and Sewerage	10
Toll Roads	7
Electric Utilities	4
Telecommunication Utilities	3

In economic terms, the involvement of the public sector is often justified since investments in the water sector generate positive externalities such as better environment, reduced incidence of water borne diseases, or increased tourism activity, especially in coastal areas where the treatment of wastewater is highly valued. Similar positive externalities exist for the solid waste management sector. In addition, for Romania, the economic gains related to EU Accession will be large. Thus, the use of public resources to meet the country's commitment towards the EU is justified.

All European Governments have provided support to the development of their own domestic water and wastewater sectors (selected examples shown in Table 2) and for the solid waste management sectors. Significant public resources have been utilized for the

[30] Efficient, Sustainable Service for All - An Evaluation of the World Bank Assistance to the Water Supply and Sanitation Sector', Operations Evaluation Department, The World Bank; September 1, 2002

development of the water and wastewater sector as the assets are largely in the public domain. Even in the United Kingdom, where the water and wastewater assets were sold to the private sector, the public sector took on the debt prior to privatization and provided tax incentives to the private operators. In summary, there is an element of investment subsidy in all EU countries.

In Romania, compared to Western European countries, the per capita cost for the infrastructure upgrading is higher, and the tariffs and household incomes are lower. Thus, the proposed expenditure framework will have to take this into account while estimating the level of sovereign support for local infrastructure development. Currently, such policies are not in place but the Government's draft Municipal Services Strategy proposes grant support for municipalities and communes either through EU grants or State budget. The level of State budget support for EU related investments are proposed as follows: a) urban area with population above 100,000 inhabitants: 50 percent; b) urban area with population below 100,000 inhabitants: 70 percent; and c) rural area: 85 percent. Before such a policy is put in place the criteria for State support should be made clear and whether such support is fiscally affordable should be determined.

Table 2
Examples of Government Support in Water/Wastewater Sector

Country	Per Capita Investment (€/year)	Average Equivalent Tariff (€/m^3)	Investment Subsidy (%)	Unaccounted for Water (%)
Austria	128	2.41	24%	8%
England	98	2.43	18% Green Dowry	29%
France	94	2.44	15%	25%
Germany	113	3.93	3% in West; 15% in East	8%
Romania	385	0.60	To be determined	Around 50%

In Western Europe, various types of State support have been provided for the development of the water and wastewater sector and strengthening the solid waste management sector. Some of them are listed below and the model chosen by Romania would have to be reflected in the expenditure framework. No operating subsidies should be provided but the central government assistance may be provided for investments, if justified and fiscally affordable:

- Direct budgetary support for investments;
- Assumption of utility debt by the public sector prior to privatization;
- Tax advantages to utilities that invest in network expansion or upgrading;
- Debt service of utilities partly serviced by the State;
- Sovereign guarantees of loans intended for sector development;
- Tax advantages to investors that purchase municipal bonds for investments.

ANNEX III

Local Government Debt Market and Access to Financial Markets

SPV structure for low to medium risk municipalities and municipal corporations

Benefits and drawbacks of SPV structure

1. The benefits of structuring a SPV are significant, given the underdevelopment of the Romanian money and capital markets. These benefits would include, among others:

- Possibility of raising financing in the domestic market, and especially in domestic currency;

- Improved market access for low to medium risk municipalities and municipal corporations, thus promoting their names and possibly graduating to stand-alone borrowers and bond issuers over the medium term;

- High degree of flexibility, both on the investment and funding side of the SPV balance sheet. The SPV could package different forms of obligations, thus better meeting the specific needs in terms of financing, maturity and other specific terms of municipalities and municipal corporations. At the same time, the SPV could issue bonds, borrow directly from banks and other investment companies in the form of loans, lines of credit, guarantees, bridge loans, etc.;

- Ability of SPV to buy small sized obligations which would not under normal circumstances access the capital and money market, with the exception of bank loans, and to package them for investors. Furthermore, the SPV would necessarily be rated by an international rating agency to ensure proper transparency, management and governance arrangements. The rating would increase the SPV marketability to both local and foreign investors, and promote the names of its final borrowers to market participants;

- Bankruptcy-remote structure, where SPV creditors are not directly connected to the final debtors, i.e. municipalities and municipal corporations. This enhances the capacity of the SPV to manage financial distress and bankruptcy at the local level through assets liquidation and general assets management and work-out techniques. Eventually, assets management services could be outsourced to specialized assets management companies against servicing contracts based on success fees; and

- Conditioning of access to SPV financing upon a number of prerequisites, requirements and parameters applicable to both municipalities and municipal corporations. These would cover areas such as fiscal sustainability; financial

soundness and performance; quality of the investment programs; leverage; legal, regulatory and judicial consistency; transparency, disclosure and accountability, and local currency credit rating (global scale).

2. The drawbacks of the SPV structure are related to the complexity of the financial structuring and management activities. In particular, SPVs' drawbacks would include, among others:

- Appropriate sequencing in the composition and development of the investment portfolios, the support investment programs of the municipalities and municipal corporations, and the associated funding. In this regard, SPVs are sometimes established by using bridge loans, which enable to build the investment portfolios before accessing the market for funding. Bridge loans would enable the manager to process all required documentation with the municipalities and municipal corporations, including performing the due diligence, preparing the prospectus, registering the pledges and processing the legal documentation, etc.;

- Management costs could become high, especially when investment portfolios are too complex and/or heterogeneous. Most commonly, SPVs are built on specific assets types or types of borrowers, to enhance transparency and marketability and management efficiency; and

- SPVs' margins are generally small, especially in a low interest environment. As a result, there might be a tendency in increasing the size of the investment portfolios to decrease the weight of fixed operating costs while accumulating resources to cover eventual losses. This would potentially affect credit policies and render the SPV highly sensitive to recovery rates and probabilities of defaults, which are not easily measurable even in the most developed market (especially in the municipal and municipal corporation markets).

Structuring an SPV in Romania: terms and requirements

3. Setting up a SPV in Romania would require a number of institutional, market and operational conditions. The SPV could be set up as a trust under the following institutional and operational arrangements:

- A Fund Manager, or Agent, who acts as organizer and manager of the SPV for its start-up and daily operations. These include accounting; treasury; investment policies; marked-to-market pricing; payments and collection of interests and installments on debt instruments; due diligence of debt issuers to assess feasibility of investment programs, fiscal sustainability, transparency and accountability; market communication and disclosure; etc. The Fund Manager should be, preferably, a local bank or investment company. An operational manual with strict requirements for eligibility, policies and guidelines, would be the basis to ensure transparency and governance. The Fund Manager should be, preferably, a local bank or investment company with a high degree of

professionalism and know-how. The SPV manager would work in liaison between the market and the municipalities and municipal corporations, ensuring that the latter consistently meet the above mentioned requirements for accessing SPV funding;

- The SPV should be all RON on both sides of the balance sheet, as to avoid currency risks;

- The overall rating of the investment portfolio should be slightly lower than the overall debt issued by the SPV itself. This to generate a credit spread making the SPV profitable and self-sustainable. The credit spread should be enhanced through either: a) liquidity back stop facilities, or credit lines, to enable the SPV to accumulate reserves and address mismatches between partial defaults of municipalities and municipal corporations, and the payments of the coupons of the SPV bond and/or the debt servicing of the SPV loans; b) a SPV bond, mainly a standard plain vanilla bond; c) equity, although in the case of Romania, a all-debt SPV would be the preferable option given low margins on the domestic debt market and d) a bridge loan, to enable the Fund Manager to build the portfolio before issuing bonds or other debt;

- In order to enhance the rating of the SPV, IFIs could provide a partial credit guarantee to the SPV itself to cover a portion of the debt obligations of the SPV itself beyond the realized recovery (as assumed, see below). Alternatively, IFIs could provide the liquidity back-stop facility to build the necessary liquidity reserves and address liquidity mismatches. The bridge loan, preferably, should be provided by the Fund Manager, to enhance ownership over the investment portfolio;

- The difficulty in assessing the feasibility of such structure is estimating the risk profile of the investment portfolio, and especially the volatility of the obligations in terms of probability of default, and the recovery rates associated with it. Given the absence of a developed domestic debt market in Romania, recovery rates and probability of default could be estimated based on international experience. For the purposes of this note, probabilities of defaults were assumed ranging between 5 and 10 percent on a five years basis, and recovery rates between 25 and 35 percent. The latter were lagged by three years, given the need to finalize the recovery of the pledges. These rates were standardized given the uncertainty related to the structure of the investment portfolio, which would vary on a strictly case-by-case basis;

- Spreads between investments were assumed again based on international experiences. This is mainly due to the absence of a developed domestic debt market, with spreads sometimes below benchmark for risky issues. In the following, we assumed an average duration of the investment portfolio of about 5 years, with spreads ranging between 150 and 250 basis points for instruments rated between single B and BB. There is some consistency in these spreads, as

Bucharest has recently issued Eurobonds with 216 basis points over the Euribor for a ten years maturity bond (See Section 2.1 above);

- Taxation is assumed even for the whole structure at the flat rate of 16 percent on capital gains;

- Recovery of defaulted obligations, thus assets management activities, are serviced-out to specialized assets management companies on a success fee based contract, or 5 percent of the recovered assets. As mentioned earlier, cash inflows from recoveries are lagged by three years, also to reflect (i) the impossibility to intercept revenues and bank accounts of municipalities, and (ii) the need of municipalities to make provisions in the finance laws for debt recoveries. The situation would obviously differ for municipal corporations, although the three years lag was assumed conservatively across the investment portfolio;

- Interest rates are assumed fixed on both sides of the SPV balance sheet, apart from the liquidity back-stop facility and the bridge loan. This would create a floating rate, or maturity risk in the balance sheet of the SPV equal to the size of the facility itself. This type of risk is generally manageable, given that there is a strong asymmetry between the steepening and flattening of the curve. The SPV would in fact be at risk in case of a flattening curve, which is generally correlated with improved market and credit conditions, which should conversely decrease the credit and default risks, thus increasing the SPV soundness and profitability. In all cases, it could e assumed that a portion of the investment portfolio is based on floating rates, e.g. loans, to perfectly hedge this exposure.

SPV base case scenario

4. The following table is a summary of the simulations ran according to the above assumptions. The overall size of the SPV is US$ 200 million, which seems feasible given the size of the Romanian municipal and municipal corporation sector. The simulation is based on projected cash flows for 20 years, although the average maturity of the investment portfolio was assumed at 10 years to reflect the mix between loans and bonds of the portfolio. As mentioned earlier, assumptions are based on international experience, given the limited development of the Romanian debt market money, but conservative.

ASSUMPTIONS and RESULTS TABLE			
Portfolio Size (US$ million)			200
LIBOR US$ (6 months)			4.85%
BUBOR (3 months - 6 months basis)			7.93%
BUBOR 12 months			7.99%
Romanian Government 5Y			4.65%
Operating Expenses (US$ million)		1 +	0.50
B +	Prob. of Default (1 year)		1.30%
B	Prob. of Default (1 year)		1.60%
B -	Prob. of Default (1 year)		2.20%
Risk Free	Prob. of Default (1 year)		0.10%
Recovery for B +			35%
Recovery for B			30%
Recovery for B -			25%
Recovery for Bucharest			75%
Basis Points for SPV bond (over BUBOR)			100.00
Size of the Guarantee (percent of SPV Bond)			25%
Put strike of SPV Bond			0%
B +	Spread	0.3%	8.2%
B	Spread	0.5%	8.5%
B -	Spread	1.0%	9.0%
Cumulative PV of Losses			0.00
Debt Repayment Ratio (percent of profits)			0%
Reserves Levels (minimum 5 percent)			10%
Real Return on Investment (RESERVES)			82.6%
PV of Outstanding Balance of Liquidity Facility			16.51

SPV structure for medium to high-risk municipalities and municipal corporations

1. The credit enhancement structure of these types of municipalities and municipal corporations would not differ considerably from the previous case, although the existence of the sovereign guarantee introduces a number of strong assumptions into the model. First of all, the guarantee was assumed at 100 percent of principal at maturity, and given that this would be a IFI guarantee backed by the counter-guarantee of the Government, the guaranteed instrument would be either the bond of the SPV or the SPV itself. In this case, there would not be the need for accumulating reserves in the SPV, given that there is no need to enhance its creditworthiness. By the same token, the SPV would not need large liquidity back stop facilities, given that between there would be short time lags between the defaults of municipalities and municipal corporations and the pay-offs of the guarantees, even if not accelerable. The SPV could in fact sell outright the pay-offs of the guarantees to institutional investors at NPV and at discount price. In all cases, a rating by an international rating agency would be warranted, to better address market distortions and mis-pricing.

2. The structure of the SPV would remain identical in terms of assets and liabilities, with the aforementioned exception of the lower reserve requirements. The maturities of the investment portfolio and SPV bond would match, for simplicity purposes. To remain conservative, the probabilities of default and the recovery rates were assumed unchanged from the previous simulations. This not because of the difficulty to correctly assess a portfolio backed by a Government guarantee, but because the more stringent the assumptions, the more feasible and profitable would become the structure. Under these assumptions, the normal distribution of the probability of default would be incorporated in the model, with the exception of the tails, which are basically the default of the sovereign debt. Municipalities and municipal corporations would have, most probably, a correlation of 1 to the default of the Government.

3. Other assumptions related to operating costs, recovery service-fees, maturities of the bonds and investment portfolios, will be maintained unchanged for simplicity purposes. Taxation will also be computed on the profits based on a flat 16 percent capital gain tax rate. Double taxation issues are not considered. The credit spreads will be instead slightly increased to reflect the higher risk of the issuers, which should incorporate their risk into the debt servicing costs.

4. Operationally, these types of SPV would still need a Fund Manager, possibly a private bank or institutional investor, to ensure maximum transparency, governance and efficiency. The operational manuals and guidelines would ensure the consistent application of good practices in terms of transparency and governance, and disclosure. Access conditions to these facilities would be based on budget management processes and disclosure requirements by the municipalities and municipal corporations, quality of the multi-year investment program, fiscal and financial soundness, forward-looking debt sustainability simulation and stress-tests, and local currency credit rating.

Risk Fund management modalities

5. In case the government provides a counter-guarantee to an IFI partial credit guarantee facility, the MEF establishes a Risk Fund that is structured so as to achieve two objectives (i) to reduce moral hazard by charging a Risk Fund fee to participating municipalities and municipal corporations and (ii) to cover a first risk tranche as defined by the MEF. In case counter-guarantee payouts resulting from local government or municipal corporation default exceed the Risk Fund coverage, the MEF steps in to honor the counter-guarantee. Counter-guarantee pay-outs are recuperated through the local government or municipal corporation bankruptcy procedures.

6. The management structure of the Risk Fund is based on four separate functions:

(i) The MEF is responsible for defining the risk and pricing parameters of the Risk Fund and for supervising its implementation. Specifically, the MEF defines the risk tranches to be covered by the Risk Fund and by the government, respectively;

(ii) Exim Bank is responsible for scoring the municipal risk according to a methodology issued by MEF Executive Order;

(iii) The MEF is responsible for defining the Risk Fund fee for each risk category given the risk covered by the Risk Fund; and

(iv) A private financial institution selected competitively manages Risk Fund cash and assets for a fee within the parameters of a management contract defined by the MEF.

Table A 1: Loans to local authorities (2001 - September 2007)

	2001	2002	2003	2004	2005	2006	Sep-07
Total loans (000, RON)	3,590	38,008	282,176	697,078	1,393,442	1,399,240	704,708
Total loans (000, $ equivalent)	1,235	11,498	84,993	213,585	478,238	498,130	286,826
of which:							
- maturity < 1 year	1,760	6,673	31,699	571,195	16,878	-	-
- maturity > 1 year	1,830	31,335	250,477	125,883	1,376,563	1,399,240	704,708
Average maturity of loans > 1 year (months)	28	37	43	49	127	170	202
Average loan size (000, RON):							
- maturity < 1 year	290	370	670	1,000	1,125	-	-
- maturity > 1 year	450	1,740	2,740	1,400	21,509	17,490	13,818
Longest maturity (months)	36	180	84	120	300	300	300
Average interest rate:							
- fix rate							
< 1 year	42.98%	26.83%	21.62%	20.82%	19.14%	-	-
> 1 year	42.69%	26.34%	23.00%	19.52%	16.90%	10.37%	9.23%
- margin over Bubor							
- maturity < 1 year		5.00%	3.97%	1.95%	-	-	-
- maturity > 1 year	-	3.27%	1.89%	2.24%	0.87%	0.78%	0.41%
By status of borrower							
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**Sep-07**
Total loans (000, RON)							
- < 1 year							
- Bucharest	-	-	-	-	-	-	-
*- Municipalities >100.000 inhabitants***	450	2,016	6,598	-	-	-	-
- Municipalities <100.000 inhabitants	760	4,350	-	4,368	200	-	-
- Cities, Communes	550	307	25,101	566,827	16,678	-	-
- > 1 year							
- Bucharest	-	-	96,358	66,344	569,413	310,000	-
*- Municipalities >100.000 inhabitants***	1,540	25,860	98,757	13,000	575,512	742,099	490,052
- Municipalities <100.000 inhabitants	160	4,980	38,475	25,363	155,379	217,759	149,568
- Cities, Communes	130	495	16,887	21,177	76,259	129,382	65,088
Average maturity of loans > 1 year (months)							
- Bucharest	-	-	75	62	250	125	-
*- Municipalities >100.000 inhabitants***	24	47	86	28	164	194	223
- Municipalities <100.000 inhabitants	28	30	59	64	92	193	163
- Cities, Communes	30	32	39	40	110	98	126
Average interest rate							
- < 1 year							
- Bucharest	-	-	-	-	-	-	-
*- Municipalities >100.000 inhabitants***	43.00%	35.38%	25.29%	-	-	-	-
- Municipalities <100.000 inhabitants	43.16%	36.02%	-	20.11%	20.00%	-	-
- Cities, Communes	42.73%	34.92%	21.24%	20.83%	19.11%	-	-
- > 1 year							
- Bucharest	-	-	23.10%	23.86%	11.54%	10.69%	-

Table A 1: Loans to local authorities (2001 - September 2007), cont'd							
	2001	2002	2003	2004	2005	2006	Sep-07
*- Municipalities >100.000 inhabitants***	NA	24.11%	21.83%	-	19.49%	8.75%	-
- Municipalities <100.000 inhabitants	42.00%	33.47%	23.90%	22.29%	21.53%	10.40%	9.46%
- Cities, Communes	43.54%	41.35%	22.65%	18.18%	17.58%	9.45%	9.04%
Average margin over Bubor							
- < 1 year							
- Bucharest	-	-	-	-	-	-	-
*- Municipalities >100.000 inhabitants***	-	-	3.96%	-	-	-	-
- Municipalities <100.000 inhabitants	-	5.00%	-	2.50%	-	-	-
- Cities, Communes	-	-	4.00%	1.91%	-	-	-
- > 1 year							
- Bucharest	-	-	2.00%	2.00%	0.60%	0.89%	-
*- Municipalities >100.000 inhabitants***	-	3.77%	1.43%	1.50%	0.74%	1.02%	0.27%
- Municipalities <100.000 inhabitants	-	0.00%	3.11%	2.62%	0.52%	0.74%	0.56%
- Cities, Communes	-	-	3.39%	4.00%	1.57%	0.51%	0.85%

** - in 2004 most were SAPARD pre-financing loans*
***- including County Councils*

Table A 2: Municipal bonds on domestic market (2001 – September 2007)

	2001	2002	2003	2004	2005	2006	Sep-2007
Total amount (000, RON)	2,250	11,900	46,504	36,716	38,750	33,150	133,000
Total amount (000, $ equivalent)	774	3,600	14,007	11,249	12,948	11,801	40,309
Average margin over Bubor3M	-0.65%	-0.53%	-0.53%	0.68%	0.32%	0.76%	0.11%
Average size (000, RON)	750	1,700	3,577	4,079	6,458	5,525	22,166
Average maturity (months)	30	26	29	40	80	198	230
Longest maturity (months)	42	30	60	72	240	240	240

By status of borrower

	2001	2002	2003	2004	2005	2006	Sep-2007
Total amount (000, RON)							
*-Municipalities >100.000 inhabitants**	-	8,000	33,500	28,800	20,000	15,000	125,000
-Municipalities <100.000 inhabitants	1,000	3,600	13,004	7,416	14,250	-	8,000
- Cities, Communes	1,250	300	-	500	4,500	18,150	-
Average maturity (months)							
*-Municipalities >100.000 inhabitants**	-	28	29	42	72	213	231
-Municipalities <100.000 inhabitants	24	24	29	42	90	-	216
- Cities, Communes	33	24	-	24	48	179	-
Average fix interest rate							
*-Municipalities >100.000 inhabitants**	-	-	14.00%	-	8.25%	-	-
-Municipalities <100.000 inhabitants	-	-	-	-	-	-	-
- Cities, Communes	-	27.20%	-	-	-	-	-
Average margin over Bubor3M							
*-Municipalities >100.000 inhabitants**	-	-0.53%	-0.67%	0.87%	-	0.79%	0.06%
-Municipalities <100.000 inhabitants	-0.88%	-0.53%	-0.23%	-0.02%	0.25%	-	0.87%
- Cities, Communes	-0.48%	-	-	0.38%	0.54%	0.74%	-

* - *including County Councils*

Table A 3: External loans to local public authorities (2001 – 2006)

	2002	2003	2004	2005	2006	Sep
Total loans (000, Euro)	90,314	70,020	115,302	158,213	218,000	264,500
Average maturity (years)	18	13	25	18	21	14
Longest maturity (years)	24	15	26	24	25	25
Average loan size (000, Euro)	12,902	17,505	1,860	5,860	15,000	31,000
Average spread over Euribor	2.25%	3.85%	3.98%	0.35%	1.00%	0.70%
By status of borrower						
	2002	**2003**	**2004**	**2005**	**2006**	**Sep-2007**
Total loans (000, Euro)						
- Bucharest)	-	51,500	-	10,000	25,000	90,200
-Municipalities>100.000 inhabitants	90,314	18,520	69,677	147,213	165,000	145,400
- Cities, Communes<100.000 inhabitants	-	-	45,625	1,000	28,000	28,900
Average spread over Euribor						
- Bucharest	-	3.90%	-	1.50%	0.25%	0.54%
-Municipalities>100.000 inhabitants	2.58%	3.75%	3.90%	0.95%	1.20%	0.60%
-Cities, Communes< 100.000 inhabitants	-	-	3.98%	-	0.25%	1.00%

Source: MEF

**) the Eurobonds issued by Bucharest are not included*

Map section


ROMANIA
SELECTED CITIES AND TOWNS
COUNTY (JUDET) CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
COUNTY (JUDET) AND MUNICIPALITY (MUNICIPIU) BOUNDARIES
INTERNATIONAL BOUNDARIES
UKRAINE
HUNGARY
MOLDOVA
SERBIA
BULGARIA
Black Sea
Carpathian Mts
Transylvanian Alps
Moldavia
Walachia
Dobrudja
Danube
Prut
Siret
Mures
Crisul Alb
Tisa
Olt
Jiu
Arges
Ialomita
Buzau
Bistrita
Somes
Timis
SATU MARE
MARAMUREŞ
SUCEAVA
BOTOŞANI
BISTRIŢA-NĂSĂUD
IAŞI
SĂLAJ
CLUJ
BIHOR
MUREŞ
NEAMŢ
HARGHITA
BACĂU
VASLUI
ALBA
ARAD
SIBIU
BRAŞOV
COVASNA
VRANCEA
GALAŢI
TIMIŞ
HUNEDOARA
VÂLCEA
ARGEŞ
BUZĂU
BRĂILA
TULCEA
CARAŞ-SEVERIN
GORJ
PRAHOVA
DÂMBOVIŢA
IALOMIŢA
ILFOV
BUCUREŞTI
MEHEDINŢI
OLT
TELEORMAN
CĂLĂRAŞI
GIURGIU
DOLJ
CONSTANŢA
Satu Mare
Baia Mare
Oradea
Zalău
Dej
Bistriţa
Botoşani
Suceava
Iaşi
Piatra-Neamţ
Roman
Vaslui
Husi
Cluj-Napoca
Turda
Târgu Mureş
Gheorgheni
Miercurea-Cuic
Bacău
Oneşti
Birlad
Arad
Brad
Alba Iulia
Medias
Deva
Timişoara
Lugoj
Hunedoara
Sibiu
Sfântu Gheorghe
Moldoveanu (2,544 m)
Braşov
Tecuci
Focşani
Galaţi
Petroşani
Reşiţa
Râmnicu Vâlcea
Târgu Jiu
Târgovişte
Ploieşti
Buzău
Brăila
Tulcea
Piteşti
Orşova
Drobeta-Turnu Severin
Slatina
Slobozia
Fetesti
BUCHAREST
Craiova
Călăraşi
Navodari
Medgidia
Constanţa
Caracal
Calafat
Alexandria
Giurgiu
Turnu Magurele
Mangalia
To Budapest
To Uzhhorod
To Ivano-Frankivs'k
To Bălţi
To Chişinău
To Subotica
To Novi Sad
To Niš
To Sofiya
To Veliko Tŭrnovo
To Shumen
To Varna
22°E
24°E
26°E
28°E
30°E
48°N
46°N
44°N
0 25 50 75 100 Kilometers
0 25 50 75 Miles
This map was produced by the Map Design Unit of The World Bank. The boundaries, colors, denominations and any other information shown on this map do not imply, on the part of The World Bank Group, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries.
FEBRUARY 2008
IBRD 33469R2