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PERFORMANCE AUDIT REPORT

ROMANIA

FINANCIAL AND ENTERPRISE SECTOR ADJUSTMENT LOAN
(LOAN 3975-0,1,2-RO)

AND

SOCIAL PROTECTION ADJUSTMENT LOAN
(LOAN 4177-RO)

February 16, 2001

Operations Evaluation Department

Currency Equivalents

Currency Unit = Leu/Lei

Average Exchange Rate (Lei to US$1)

1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
1,276	1,767	2,578	4,035	8,023	10,951	18,255

Abbreviations

CAS	Country Assistance Strategy
EBRD	European Bank for Reconstruction and Development
ESPP	Employment and Social Protection Project
EU	European Union
FESAL	Financial and Enterprise Sector Adjustment Loan
FIAS	Foreign Investment Advisory Service
GDP	Gross Domestic Product
ICR	Implementation Completion Report
IFC	International Finance Corporation
IMF	International Monetary Fund
MIG	Minimum Income Guarantee
MIGA	Multilateral Investment Guarantee Agency
NBR	National Bank of Romania
OED	Operations Evaluation Department
PAR	Performance Audit Report
RA	*Regies Autonomes*
SOF	State Ownership Fund
SPAL	Social Protection Adjustment Loan
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
UNDP	United Nations Development Programme

Director-General, Operations Evaluation:	Mr. Robert Picciotto
Director, Operations Evaluation Department:	Mr. Gregory K. Ingram
Manager, OEDCR:	Mr. Ruben Lamdany
Task Manager:	Ms. Alice Galenson

The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

February 16, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Romania—Financial and Enterprise Sector Adjustment Loan (FESAL), Loan 3975-0,1,2-RO; and Social Protection Adjustment Loan (SPAL), Loan 4177-RO

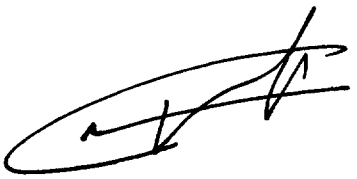
Attached is the Performance Audit Report for Romania: the Finance and Enterprise Sector Adjustment Loan for US$280 million and the Social Protection Adjustment Loan for US$50 million. FESAL was approved by the Board in December 1995 and cancelled in April 2000, ten months after the scheduled closing, with the last tranche of US$100 million remaining undisbursed. SPAL was fully disbursed and closed on schedule in December 1997.

FESAL's objectives were to transfer the Romanian enterprise and financial sectors to private ownership within a policy framework that promoted competitive private sector and capital market development. It sought to enforce hard budget constraints and financial discipline on remaining state owned enterprises to reduce the quasi-fiscal deficit and move these enterprises towards closure, liquidation or privatization in the future. These objectives were consonant with Romania's development strategy and the Bank's assistance strategy for that country.

Project implementation was partially successful: foreign exchange, prices and trade were de-regulated; the mass privatization program, though complex, achieved its objectives; prudential regulations and supervision for banks was improved; and capital markets were established. Some important reforms were unsuccessful: the case-by-case privatization targets for large enterprises and banks were not met; and the enterprise restructuring and surveillance programs did not yield the expected results. Thus, only a small proportion of state owned enterprise and bank assets changed to private ownership. The project was closed when it became evident that some loan conditions would not be met in a reasonable period of time. The Evaluation Summary rated outcome as unsatisfactory, institutional development impact as modest, sustainability as likely and Bank performance as unsatisfactory. This audit agrees with those ratings, except for that of outcome, which it rates as only moderately unsatisfactory, in recognition of reforms implemented during project preparation and since the project closed.

SPAL's main objective was to ensure adequate social protection while macroeconomic stabilization and structural reform measures were being implemented. It also sought to promote medium-term reforms in Romania's social protection system. These objectives supported the government's development goals and the Bank's assistance strategy. SPAL succeeded in temporarily stemming the increase in poverty, but some short-term and all the long-term measures were delayed. SPAL reforms did not take root during the loan period but are continuing at a slow pace. Thus, SPAL contributed by initiating the reform process. The Evaluation Summary rated outcome as marginally satisfactory, institutional development impact as modest, sustainability as uncertain and Bank performance as satisfactory. This audit agrees with the first two ratings; raises the rating of sustainability to likely, given the government's commitment to improving social protection; and confirms the rating of Bank performance as satisfactory, although it was only marginally so.

A number of lessons can be drawn from these projects: (i) for policy loans, a better understanding of the country's political economy would be helpful in judging what can be accomplished during the project period; (ii) for complex loans covering many policy areas and agencies, a careful assessment of impediments to successful implementation is needed, including the government's ownership of the program, its implementation capacity, and laws and regulation that need to be changed; (ii) loans with a limited number of conditions and a few meaningful overall targets are preferable to those with many conditions with outcomes that are difficult to measure; and (iii) several sequenced loans, each covering a specific area are more likely to succeed than omnibus loans covering many policy areas.



Contents

This report was prepared by Ashok Khanna (Consultant), with Alice Galenson as Task Manager. Silvana Valle provided administrative support.

Preface

This is a Performance Audit Report (PAR) on the Financial and Enterprise Sector Adjustment Loan for $US170 million, DM 135 million and FF 100 million (US$280 million equivalent) and the Social Protection Adjustment Loan of US$50 million. The PAR is based on the President's Reports for the projects, summary of the Board discussions, legal documents, project files, related economic and sector work, discussions with Romanian officials and the IMF, other donors and Bank Group staff, and Implementation Completion Reports prepared by the Europe and Central Asia Regional Office, issued in May 1999 and June 1998 respectively.

An OED mission visited Romania in March 2000 to discuss the effectiveness of Bank assistance with Government officials, donors and other stakeholders. Their cooperation and assistance in preparing this report is gratefully acknowledged.

The draft PAR was sent to the Borrower: their comments have been fully taken into account and are reproduced as Annex C to the report.

Abstract

FESAL's objectives were to transfer the Romanian enterprise and financial sectors to private ownership within a policy framework that promoted competitive private sector development. SPAL's objective was to strengthen the social safety net during the transition to a private economy and promote medium-term reforms in the social protection system. The projects' funds provided balance of payments support for imports and budget support from counterpart funds. FESAL's preparation was prolonged and it was revised after a new government took power in late 1996. It was a complex loan with many conditions attached to disbursement. Several objectives were achieved during preparation, implementation and subsequent to closure, but some important ones were not. The project did not have the anticipated impact in transforming the enterprise and financial sectors. Its last tranche was cancelled because important conditions were judged as not likely to be met within a reasonable period. FESAL's outcome is rated moderately unsatisfactory but its sustainability is likely. SPAL was fairly successful in meeting its short-term objectives of ameliorating the increase in poverty in Romania but several measures were delayed. Medium-term reform measures were even more delayed but are making progress slowly. SPAL's outcome is rated moderately satisfactory, and its sustainability is likely.

Romania—Performance Ratings

	Financial and Enterprise Sector Adjustment Loan (Loan 3975-0,1,2-RO)		*Social Protection Adjustment Loan (Loan 4177-RO)*	
	ES	*PAR*	*ES*	*PAR*
Outcome	Unsatisfactory	Moderately Unsatisfactory	Marginally Satisfactory	Moderately Satisfactory
Sustainability	Likely	Likely	Uncertain	Likely
Inst. Devt. Impact	Modest	Modest	Modest	Modest
Borrower Performance	Unsatisfactory	Unsatisfactory	Satisfactory	Satisfactory
Bank Performance	Unsatisfactory	Unsatisfactory	Satisfactory	Satisfactory

Key Project Responsibilities

	Financial and Enterprise Sector Adjustment Loan (Loan 3975-0,1,2-RO)		
	Task Manager	*Division Chief/Sector Leaders*	*Director*
Appraisal	Patrick Tardy	n.a.	Rachel Lomax
Completion	Patrick Tardy	Gerhard Pohl, Hennie Van Greuning, Yasuo Izumi	Andrew Vorkink

	Social Protection Adjustment Loan (Loan 4177-RO)		
	Task Manager	*Division Chief/Sector Leader*	*Director*
Appraisal	Arna Hartmann	Ralph W. Harbison	Kenneth Lay
Completion	John Innes	Michal Rutkowski	Christiaan Poortman

1. Introduction

Background

1.1 *Economic and political.* Romania's population of about 23 million makes it the second largest Central and Eastern European country. With a GDP per capita of about US$1,500, it ranks behind its neighbors such as Hungary, Slovakia, the Czech Republic and Poland. Romania has substantial potential because of favorable natural endowments and a well-educated labor force. In 1995, industry and services accounted for about 40 percent of GDP each, with agriculture contributing the remaining 20 percent.

1.2 Communists ruled Romania for over forty years until the revolution in December 1989. The legacy of decades of central planning remains, however. The government that followed the revolution adopted a cautious approach to economic reform. Consequently, needed structural adjustments were not made, resulting in lower economic indicators by 1996. Elections at the end of 1996 changed the political landscape. The new leadership had a mandate to liberalize the economy, privatize state-owned enterprises and accelerate Romania's integration into the European Union (EU).

1.3 *Macroeconomic.* Romania's economic performance since the revolution has been disappointing. A government that supported reforms took office in 1997, and substantially liberalized the foreign exchange markets, prices and agricultural trade. Nevertheless, large fiscal and quasi-fiscal deficits, partly due to slow enterprise reform and privatization, and a weak financial system have contributed to high inflation and negative economic growth between 1997 and 1999.

Table 1.1: Selected Economic Indicators

	1994	*1995*	*1996*	*1997*	*1998*	*1999*
Real GDP Growth (%)	3.9	7.1	3.9	-6.1	-5.4	-4.5
Inflation, Consumer Prices (annual %)	137.0	32.3	38.8	154.8	59.1	46.0
Unemployment (%)	10.4	9.5	6.5	8.9	10.4	11.3
Government Balance (%GDP), excluding privatization receipts	-2.2	-3.4	-4.8	-5.2	-5.5	..
Average Interest Rates (%)	78.0	67.0	66.9	138.8	105.0	..
Current Account Balance (%GDP)	-1.7	-4.9	-7.4	-6.2	-7.5	-3.9
Debt Service Ratio (%)	9.2	10.1	12.6	19.1	21.8	..
Official Exchange Rate (LCU per US$, period average)	1655.1	2033.3	3084.2	7167.9	8875.6	15332.8
REER (base year varies by country)	85.8	83.9	75.8	88.4	114.9	97.8

Sources: World Bank SIMA database as of January 22, 20001; IMF Article IV Consultation Report, October 6, 1998; IMF Letter of Intent, July 26, 1999; and Government of Romania

1.4 The budget has come under pressure because of bank recapitalization requirements and changes in the tax system that reduced taxes. Moreover, recorded budget deficits exclude losses in state enterprises and associated bad loans made by state owned banks. While tight monetary policy lowered inflation in 1998, high interest rates stifled production and led to the Lei's real appreciation. Because of exchange rate appreciation, Romania lost external competitiveness, with relative unit labor costs in

dollars rising by 38 percent in 1998. Competition from East Asian exporters also intensified. As a result, the current account deficit increased sharply.

1.5 *Enterprise and finance sectors.* Before the revolution, virtually no private sector existed in Romania. By the end of 1993, the private sector generated about 35 percent of GDP, mostly in services and private agriculture. Industry was still state owned, but 6,300 commercial companies and the legal and institutional structure for privatization had been established. In addition, 900 Regies Autonomes (RA) were formed for strategic enterprises such as utilities that were expected to remain in state ownership. The pace of privatization judged by value of enterprises has been slow. During the period 1990-97 only 10 percent of the State Ownership Fund (SOF) capital was privatized.[1] The pace accelerated in late 1998 and in the first quarter of 1999 when 8 percent and 5.7 percent respectively of SOF's capital was privatized. The state enterprise sector has also been plagued by a lack of financial discipline, with losses covered by various subsidies. By 1996, enterprise arrears had been cleared three times and 150 of the largest SOEs posted losses, amounting to 6 percent of GDP. About 80 percent of these losses were in 75 firms, including public utility RAs (because of pricing policy) and commercial companies such as in the mining sector. By 1997, the total payments due from arrears between enterprises and enterprises to the budget and loans from state owned banks amounted to 35 percent of GDP.

1.6 Financial system reforms have made some progress but with setbacks. Romania's socialist banking system has been substantially transformed into a market economy two-tier system. The National Bank of Romania was established as the central bank with a regulatory framework permitting it to supervise the banking system. By 1998, forty-five licensed banks were operating, including seven state owned banks. The top four state owned banks, however, still accounted for about two-thirds of banking assets and credits in mid-1998. By 1999, one state owned bank had majority private ownership (Romanian Bank for Development) and another had 35 percent private ownership (Banc Post). Moreover, one state owned bank (Bancorex) has been liquidated and another is being restructured (Banc Agricola). Several banks have, however, failed and/or required recapitalization at a cost to the government of about 1.5 percent of GDP in 1996, 1.7 percent of GDP in 1998 and 2 percent of GDP in 1999.

1.7 *Social protection.* In 1994, 5 million people were living below the poverty line (US$3.30/day), up from 1 million before the transition. As Table 1.1 shows, unemployment has been high and rose in 1998-99, suggesting an increase in poverty since 1994. It is expected to rise further with enterprise liquidations, restructuring and privatization. The government improved its income transfer, direct transfer and pension programs, and designed a poverty alleviation strategy. It also introduced supportive labor market measures such as training and placement services. At the same time, increased fiscal pressure has constrained social protection expenditures. Under these difficult circumstances, some of Romania's health indicators have worsened, but some have improved. Education indicators compare well with countries at similar income levels. Women's participation in the labor force is as high as men's, but their position in society

1. The SOF exercises the state's ownership rights until commercial companies are privatized.

remains weak. Women are not well represented in political bodies and senior decision making positions. They also bear the brunt of poverty. Despite improvements in the maternal mortality ratio, reproductive health care is weak. Females are, however, more likely than men to complete their formal education and possess a university degree.

World Bank Group Relations with Romania and other Donors

1.8 World Bank lending to Romania resumed in 1991 and the country became a member of the IFC in 1990 and MIGA in 1992. IFC has tried to provide assistance for privatization and to privatized enterprises including some utilities, but the process has been slow. It is looking to expand activities as the policy environment improves. For small and medium sized private enterprises, IFC has strengthened financial intermediaries to channel funds for investment and working capital. IFC is promoting financial sector development through participation in bank privatization, brokerage operations and insurance companies. For example, in 1999, it made a subordinated loan to participate in Banc Post's privatization. In manufacturing, IFC is considering investments in wood processing, building products, petrochemicals, aluminum, automobile parts, textiles and food processing. IFC is also seeking to support infrastructure restructuring that promotes private sector development. MIGA concluded a Legal Protection Agreement and a Use of Local Currency Agreement with Romania. It is providing a guarantee for a mining sector investment. Other projects have been registered with MIGA. Wider efforts to attract foreign direct investment will build on work done by MIGA and FIAS.

1.9 World Bank staff have worked closely with the IMF, EU, EBRD and major bilateral donors. The partnerships have yielded cofinancing from the EU and bilateral donors and several joint studies. EU and USAID provided technical assistance for implementing several components of FESAL. The Social Protection Adjustment Program was prepared by a joint (government/EU/World Bank) Task Force and coordinated with USAID, UNICEF and UNDP.

2. World Bank Assistance Strategy, Credit Objectives and Design

World Bank Assistance Strategy

Financial and Enterprise Sector Adjustment Loan (FESAL)

2.1 FESAL was presented to the Board in December 1995 as part of a country assistance strategy sent to the Board in March 1994. The strategy assumed a better macroeconomic framework leading to a sustained reduction in inflation, accelerated privatization and improvements in sectoral policies, especially in agriculture, human resources and infrastructure. The lending program focussed on supporting five main areas for reform or development: (a) privatization and private sector development; (b) energy policy and prices; (c) social protection and human resource development; (d)

agriculture; and (e) infrastructure. Promoting privatization and private sector and credit market development were at the heart of the lending program to generate economic growth. The strategy's implicit objectives of supporting Romania to achieve macroeconomic stability, make the transition to a market economy and generate growth were relevant for the country.

Social Protection Adjustment Loan (SPAL)

2.2 SPAL was presented to the Board in May 1997 together with a country assistance strategy that focussed on delivering growth, strengthening the social safety net and enhancing human capital. The strategy was based on providing strong support to the newly elected reformist government with lending and non-lending services. Specifically, it included: (a) revamping FESAL with the government's cooperation to reduce state enterprise losses, simplify privatization, renew efforts to privatize state owned banks and improve the banking system; (b) implementing the SPAL to increase social protection spending to provide a shield against the impact of the transition to a market economy by protecting the most vulnerable groups; and (c) implementing the Agriculture Sector Adjustment Loan that would reduce subsidies, liberalize prices, end directed credit, begin reforming the land market, and realign the Ministry of Agriculture to support private farming. The 1997 CAS objectives were similar to those of the 1994 CAS and were relevant for Romania.

Credit Objectives and Design

Financial and Enterprise Sector Adjustment Loan

2.3 The loan provided balance of payments funds to the government while it pursued macroeconomic stability and structural reform towards a market economy. Bank senior management required a comprehensive reform program patterned on the successful reforms in Poland. FESAL's principal objectives and components were: (a) a sharp acceleration of state owned enterprise privatization; (b) eliminating constraints to private sector activity; (c) enforcing hard budget constraints and financial discipline on remaining state owned enterprises; (d) restructuring and privatizing state owned banks; (e) strengthening the National Bank of Romania's supervisory and surveillance capacity; and (f) developing capital markets. FESAL was expected to disburse in four tranches, including a floating tranche, each linked to fulfilling specified conditions.

2.4 Romania elected a new government in late 1996, after FESAL's first and floating tranches had been released. Its platform was more reformist than the earlier government. The Bank's senior management decided to risk revising the FESAL to accelerate reforms. While the primary objectives remained the same, the new program added components such as price and trade liberalization and adjustments in utility tariffs. It also deepened the program by requiring more demanding targets in some reform areas such as privatization and company liquidations. Many new components required significant changes in Romanian law.

Social Protection Adjustment Loan

2.5 The main objective of this loan was to ensure adequate social protection while macroeconomic stabilization and structural reform measures were being implemented. Because of limited preparation time, the loan supported existing social protection schemes, but it also aimed to lay the framework for medium and long term reforms to make the system more effective in protecting the poor, while ensuring fiscal viability. The short-term components included: increases in universal child and family allowances; full indexation for agricultural pensions and Minimum Income Guarantee Scheme; broadening of feeding programs; strengthening of supplemental social protection schemes; providing temporary support during elimination of the bread subsidy; establishing lifeline rates for electricity; severance payments for redundant miners; and support services for the unemployed. The support to medium term reforms included evaluation of various social assistance benefits, preparation of a new pension law, introduction of a private pension system and preparation of a long-term poverty alleviation strategy.

3. Implementation Experience

Financial and Enterprise Sector Adjustment Loan

3.1 FESAL became effective in February 1996. The first tranche (US$60 million) and the floating tranche (US$40 million) were disbursed upon loan effectiveness. The second tranche (US$80 million) was disbursed in two parts on June 12 and 17, 1997. The third tranche (US$100 million) was cancelled because privatization of state enterprises and banks and state enterprise loss reduction and financial discipline targets were not met. The loan's closing date was extended from December 31, 1997 to April 30, 1998.

3.2 The FESAL program succeeded in some areas and failed in others. Because FESAL preparation occurred over a four-year period, many of the conditions had been implemented, with the help of Bank staff and technical assistance, before the loan was presented to the Board. While the Prime Minister of the new government backed the reforms, many senior politicians did not. Indeed, several cabinet members had little awareness of FESAL. Moreover, senior bureaucrats and enterprise and bank managers resisted the reforms. Thus, the government's ownership and commitment to the program were much weaker than senior Bank management expected. In addition, delays and deficiencies in the new laws, regulations and norms also contributed to the dismal results. Finally, despite prolonged preparation and ample technical assistance, the government's capacity to implement such a complex loan was overestimated.

3.3 Initial and revised macroeconomic targets agreed with the IMF were not met, contributing to the need to revise FESAL. The Stand-by Agreement lapsed in May 1998, with only two out of five tranches released. Several performance criteria, especially in the structural adjustment components related to the enterprise and financial sectors, were missed by a wide margin in both the September 1997 and March 1998 reviews. On the other hand, foreign exchange, price and trade liberalization was successful. Product

prices were deregulated on schedule and mechanisms established to adjust utility rates regularly. All export bans and quotas were removed, except for timber.

3.4 *Enterprise sector.* Enterprise privatization targets, the key objective of the program, were substantially met in terms of number of enterprises. The FESAL target was 3,600 enterprises, including at least 500 medium and 100 large enterprises. In fact, 3,525 enterprises were privatized including 745 medium and 125 large enterprises. In particular, the mass privatization program, while unduly complicated, was successfully implemented. Nevertheless, although substantial shareholdings were sold, the program did not succeed in transferring control to private owners in many cases; SOF retained a majority stake in many enterprises, especially large ones.[2] Thus, privatized enterprises comprised only 20 percent of the SOF's initial capital stock and less than 10 percent of the total capital stock of state owned enterprises, including the Regie Autonome. Ten years after the revolution, Romania's industry largely remains in the public sector. The privatization law was amended in early 1997 to accelerate privatization. At the same time, the revised FESAL added specific privatization targets for different privatization methods. None of these targets were met by a wide margin, although progress has continued after FESAL's closure.

3.5 The initial program for enterprise restructuring and loss reduction failed. Imposing cost cutting measures and restoring financial discipline in loss-making enterprises proved extremely difficult. Under the initial program, 151 enterprises were placed under surveillance, representing about 45 percent of losses and arrears. Many of the biggest loss-makers were not included such as the Regie Autonome for coal mining, zinc and lead, precious metals, national television and radio, road maintenance, irrigation and the largest refinery (only 19 of the 151 selected companies were among the biggest loss makers). At the same time, 77 poultry and pig farms were included although they were not among the largest loss-makers. Thus, enterprises were not well targeted to contain the quasi-fiscal deficit. In any case, only half these companies met the program objectives for privatization, liquidation or merger and restoring profitable operations in a period of 28 months. The government and the Bank acknowledged the program's failure in early 1997. It was discontinued and replaced by new measures under the revised FESAL. The new program focused on 70 enterprises that accounted for 67 percent of total losses. It achieved partial success with utilities by establishing tariff adjustment mechanisms; substantial success in the mining sector; and little success with commercial companies. The objectives of the restructuring program were not achieved, especially in restructuring utilities and closing non-viable commercial companies. Resistance from unions and other vested interests proved too strong and political commitment was too

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2. The status of some of the shares is uncertain. More than 15 million Romanians have became shareholders. Individuals were expected to give the vouchers to one of five private ownership funds, which were supposed to bid for shares on their behalf; these funds collected less than 15 percent of the vouchers. However, a special provision under the program created an interim central share registry that would allow for share registration under the mass privatization program and endorsement by the government. This registry was successfully created. As a result, the managers of state owned enterprises and of partially privatized firms lost control of share registries, which paved the way for the creation of the capital market and for future redistribution and concentration of share holdings by allowing unconstrained share trading among individuals.

weak. Moreover, the legal framework and judicial system was inadequate for expeditious liquidation of non-viable companies.

3.6 The program to restore financial discipline in enterprises under surveillance failed. The initial program placed a cap on support from the state, SOF and banks. The ceilings were too generous, allowing enterprises to renegotiate their debts without undertaking cost-cutting measures. Far from decreasing, aggregate payments arrears increased to 27 percent of GDP by end-1996, up from 18 percent of GDP at the end of 1995. A new attempt to tackle this problem under the revised FESAL also failed. Payments arrears to the budget and the two largest utilities were targeted. Needed measures were not implemented or were reversed because of labor and political opposition.

3.7 The objective of reducing employment in over-staffed state owned enterprises was met before Board presentation: 40,000 employees were laid off, triggering the release of the US$40 million floating tranche. The private sector development program, a minor component, was successfully implemented. A simplified procedure for registering enterprises, based on a survey of 400 small firms, was implemented. Also, the law guaranteed equal access to public sector procurement.

3.8 *Financial sector.* FESAL envisaged the privatization of one state owned bank by second tranche release and a second bank by third tranche release. While these privatizations did not occur according to schedule, they were almost entirely completed by April 1999. In December 1998, 51 percent of the Romanian Bank for Development was sold to Societe Generale de France and in April 1999, 35 percent of Banc Post was sold to GE Capital and 10 percent to Banco Portugues de Investimento. In addition, IFC and EBRD have made subordinated loans to Banc Post that are convertible into equity. These banks are, however, among the small state owned banks. Therefore, the banking system remains substantially in the public sector.

3.9 A key objective of FESAL was to strengthen the banking sector by improving regulations and supervision, recognizing loan losses and progressively recapitalizing large banks from retained earnings. While many banks improved their capital base during 1996-98, three private banks became bankrupt. The workout of these private banks has taken a long time because of legal challenges by management and shareholders. One bank has closed and another is in judicial proceeding but with a liquidator appointed. The third bank was recapitalized and is functioning normally. In addition, two state-owned banks received massive financial support from the government, putting additional pressure on the budget. Bank Agricola is undergoing a complex restructuring to improve its operational and financial management. The restructuring of Bancorex (with 25 percent of total banking assets) was delayed for political reasons. A new management team was appointed in April 1998 and a tender issued to select an investment bank as restructuring advisor. Bancorex has since been liquidated and Bank Agricola and the Romanian Commercial Bank are slated for privatization under the Bank's new structural adjustment loan. Bank restructuring and privatization were delayed partly because senior managers of the big state owned banks, backed by politicians, were able to resist the central bank.

3.10 Banking laws were substantially improved, however. The new laws strengthen NBR's prudential regulations and supervisory powers, require independent audits of banks, establish credit contracts backed by collateral with executory titles and require minimum qualification for bank managers. A chart of accounts that conforms to International Accounting Standards has been adopted. While risk-based bank supervision is improving, NBR has not reacted quickly or effectively in several troubled banks because of poor staffing, training and organization. In 1996, a well-designed deposit insurance scheme funded by bank contributions was introduced. It did not become operational in time for two private bank failures; consequently, depositors were reimbursed from budgetary funds. The Savings Bank was converted into a full-service savings bank, but with the state continuing to guarantee deposits.

3.11 FESAL's capital market objectives were successfully met. The Bucharest Stock Exchange was established and the RASDAQ provided an effective market for trading shares of companies privatized under the Mass Privatization Program.

Social Protection Adjustment Loan

3.12 SPAL became effective in August 1997 and was released in a single tranche of US$50 million in September 1997. The structural reforms were implemented much more slowly than expected. Nevertheless, poverty in Romania has probably increased since 1997 (discussed below). The main project objective, to ensure adequate social protection on an emergency basis, was temporarily achieved. The project covered five areas.

3.13 *Measures to improve income transfer programs for vulnerable groups.* Because the Minimum Income Guarantee program (MIG) had problems with eligibility criteria, SPAL sought to emphasize other programs and improve MIG. An increased child and new family allowance program was successfully implemented in two steps resulting in 5.2 million children receiving increased allowances. In addition, as agreed under SPAL, income thresholds for MIG were adjusted for inflation periodically. This adjustment occurred four times in 1997 and once in 1998. Nevertheless, the number of beneficiaries and their purchasing power decreased. This occurred partly because payments were at the discretion of local authorities that withdrew support for various reasons after one year of central government support and family allowances lifted former beneficiaries over the income threshold. A new law, approved by the government in December 2000 and submitted to Parliament, is backed by earmarked funds to improve the program. Forthcoming World Bank loans are expected to continue reforms and professionalize social assistance with fiscal support.

3.14 *Assisting direct transfer programs aimed at strengthening existing social feeding programs, providing temporary cash benefits and life-line rates for electricity.* Due to delays in passing the enabling legislation, the soup kitchen program performed poorly in the winter of 1997/98 and the number of meals served per day in 1997 fell by 20 percent from the previous year. In addition, local budgets could not sustain the program. Cash transfers to compensate for the removal of the bread subsidy and life line rates for electricity were fully implemented.

3.15 *Improving the public pension system and introducing a private pension system.* As agricultural pensioners were the most vulnerable, the minimum agricultural pension was increased, and it was adjusted periodically by the official inflation index. While the average agricultural pension kept pace with inflation, pensioners below the inflation indexed pension ceiling became poorer because of the linear indexation of benefits and the country's poor economic performance. Nevertheless, the situation would have been worse had the minimum agricultural pension not been increased. The Public Pension Law was drafted in 1997, but its passage through parliament was delayed until 2000 because of political difficulties and disagreements with the Bank over eligibility criteria and the scheme's fiscal sustainability. The law, which is to enter into force on April 1, 2001, provides for the establishment of the National Pension House and Other Social Insurance Rights, with the responsibility of managing the social insurance budget. A private pension law is expected to be a condition of new World Bank loans. Establishing a Commission for pension reform with a clear mandate and responsibility would have expedited the reform process.

3.16 *Supporting a labor redeployment program comprising severance payments and active labor market measures.* The Severance Payment Program was well designed with provisions for smooth implementation. Almost 180,000 displaced workers benefited from the program during 1997. The government developed a separate scheme for the mining sector that was not a part of SPAL conditionality. Almost 75,000 miners received severance payment in 1997. The miners' program was mismanaged, however. Company managers advised employees to take the severance payments with the understanding that they would be rehired in six months. Employees spent their severance payments but were not rehired, with political ramifications. After significant delays, the active Labor Market Measures Program, comprising counseling, training, placement and new business incubation services and a public works program, became effective in December 1997. Program implementation started in areas with the highest unemployment rates. By the end of 1999, the programs had assisted about 10 percent of the registered unemployed.

3.17 *Designing a poverty alleviation strategy.* The National Commission for Poverty Alleviation was established at the end of 1997 with the President as chairman. Its objective is to prepare a comprehensive poverty alleviation strategy, design implementation programs and identify means to support implementation. Several related studies were completed but the strategy has not yet been made operational. The government's Medium-Term Economic Strategy provides for the establishment of a monitoring department for poverty alleviation policies in the Prime Minister's Office, which should help operationalize the strategy. Moreover, the Romanian Fund for Social Development, established under the Social Development Fund project (co-financed by the World Bank and the Council of Europe Development Bank), will pursue poverty alleviation through grants for poor communities and less favored groups.

4. Outcome and Assessment

Finance and Enterprise Adjustment Loan

4.1 FESAL's main objectives were consistent with Romania's development strategy—to transfer state ownership of its industrial and financial sectors to private ownership with appropriate safeguards to ensure competition and a sound financial system. Moreover, privatization of enterprises and banks and promoting private sector development were central to the Bank's broad goal of private sector development and its assistance strategy for Romania in the 1994 and 1997 CASs.

4.2 FESAL achieved some important objectives. Many enterprises were privatized and substantial financial sector reforms were implemented. Foreign exchange, price and trade liberalization and improved private sector regulations were also important achievements. At the same time, however, some important objectives were not achieved. By value, only a small proportion of state enterprise assets passed into majority private ownership and financial discipline was not enforced on large loss-making state owned enterprises. The government failed to privatize any state owned banks. Indeed, the Bank was unable to prevent a massive recapitalization of two state banks. Also, the resolution of several failed private banks was stalled. Thus, neither the original nor the revised FESAL transformed the finance and enterprise sectors nearly to the extent envisioned. Moreover, the persistent violation of the conditionality covering enterprise arrears contributed materially to the violation of Romania's fiscal deficit ceilings, and to the demise of both the December 1995 and May 1997 stabilization programs.

4.3 The Bank's senior management under-estimated the new government's commitment to reform and its implementation capacity. Also, Bank staff and management did not fully appreciate the complex political economy of implementing reforms involving politicians, enterprise and bank managers and other stakeholders. Consequently, FESAL targets were unrealistically high. In addition, FESAL's processing costs of about 770 staff weeks and US$2.44 million were extremely high. This high cost resulted from loan preparation extending over several years, extensive mid-stream revision of the loan and substantial technical assistance provided during supervision missions.

4.4 Based on the above, *FESAL's outcome is rated moderately unsatisfactory.*[3] This rating is higher than the Evaluation Summary rating of unsatisfactory in recognition of reforms implemented during project preparation and reforms that have been implemented since the project closed.

4.5 Despite the disappointing outcome, the reforms achieved under FESAL are not likely to be reversed. Romania must continue the reform process to transform itself into a

3. The government notes that the FESAL paved the way for a more successful adjustment program—the Private Sector Adjustment Loan—which achieved or exceeded virtually all of its objectives due to a more adequate economic environment and stronger commitment by the Romanian authorities.

market economy and resume economic growth. Political and legal impediments that prevented a more rapid pace of reform have begun to crumble. The pace of enterprise and bank privatization picked up in late 1998, after the President of SOF was replaced, and accelerated in the first quarter of 1999. During that quarter, 585 enterprises (about 6 percent of SOF's capital), including 35 large enterprises and two banks, were privatized. In addition, steps have been taken to further reduce losses in the coal, metallurgical and mining sectors that account for about one-third of state enterprise losses. Restructuring and privatization of two major state banks are underway and NBR's bank supervision capacity is being enhanced. Thus, the sustainability of reforms initiated under FESAL, although incomplete, is rated *likely*. The Evaluation Summary also rated the sustainability as likely.

4.6 Romanian officials did not have the capacity to implement FESAL, a wide-ranging and complex loan with numerous conditions. Although the loan did not have an institutional development component, substantial technical assistance was provided from other sources such as the EU, USAID and bilateral trust funds administered by the World Bank. In addition, a high proportion of the substantial staff weeks used in loan preparation and supervision was spent on technical assistance. Some of the assistance has been effective. For example, SOF privatization and NBR bank supervision staff have improved their capability. In other areas, such as enterprise and bank restructuring, the impact may not be durable. Thus, FESAL's contribution to *institutional development* is rated *modest*, the same as in the Evaluation Summary.

4.7 FESAL preparation started in late 1991 and the loan closed in early 1998. Throughout this period, FESAL objectives were consonant with the Bank's assistance strategy for Romania and provided assistance for the country's main development objectives at a crucial political turning point. Moreover, the project was flexibly adapted during preparation and in early 1997, when a change of government promised a faster pace of reform. While the project was timely, and promised to make a contribution to important development goals, the support for reform among many senior politicians, enterprise and bank managers and labor was weak. Thus, project identification and appraisal were deficient in gauging borrower ownership of the reforms. Project preparation was protracted, lasting about four years and spanning two governments. Bank staff provided advice and support to guide the government in crystallizing programs and actions for implementation. However, the periodic presentation of new conditionality matrices confused many counterparts and eroded the Bank's credibility. Government officials, on the other hand, did not consult with the main stakeholders sufficiently to gain their full support for the reforms. Thus, project preparation was weak. During appraisal, Bank staff underestimated the staff, skills, and coordination required, and the impediments posed by the legal framework to successful implementation. While recognizing that the loan lacked focus, was extremely complex (68 conditions and 36 covenants) and was fraught with political difficulty, Bank staff did not take full cognizance of these risks during appraisal or provide adequately for their mitigation. Thus, project appraisal was inadequate. These factors (lack of political will, management and labor resistance, poor legal framework, poor project design, inadequate government capacity and coordination) prevented successful implementation of many important FESAL components, despite substantial support from Bank staff during

supervision. Based on all of the above factors, *Bank and borrower performance are rated unsatisfactory.* The Evaluation Summary also rated Bank and borrower performance as unsatisfactory.

Social Protection Adjustment Loan

4.8 SPAL's main objective was a prominent part of the Bank's assistance strategy for Romania. It was also directly relevant for Romania's development objectives, as the newly elected government's reform thrust was expected to result in increased unemployment and poverty during the transition to a market economy. The reforms were not implemented vigorously, but poverty increased nevertheless. SPAL had five components, mostly aimed at bolstering the existing social protection programs, but also directed at medium term reforms. Although SPAL was not able to halt the deterioration in the general living standard, it temporarily helped keep a segment of the population from falling into deep poverty during a period of weak economic performance. Medium term reform of the income transfer programs, pension system and the strategy for poverty alleviation are still incomplete. When these reforms are completed, SPAL will have had a significant catalytic impact on Romania's social protection system. The project was completed very efficiently at a cost of only thirty-eight staff weeks and US$75,000. While SPAL achieved a lot quickly in a difficult environment, and contributed to initiating the reform process, it achieved its main objective only temporarily and its medium term reforms remain incomplete. SPAL's *outcome* is therefore rated *moderately satisfactory* in agreement with OED's Evaluation Summary.

4.9 SPAL was prepared quickly partly because of strong government ownership and political support for social protection reforms. For example, by Board presentation, the legal framework to enable project implementation had been passed. Government officials either designed or participated cooperatively in designing the medium-term reform measures. Moreover, project activities received support from complementary activities under the Employment and Social Protection Project (ESPP), another Bank project. Thus, only the lack of government resources endangered the project's future sustainability. As the government was and is committed to providing better social protection during the transition, SPAL's *sustainability* is rated *likely.* OED's Evaluation Summary rated sustainability as uncertain because the longer-term reforms of the social protection system had not been implemented at the time of the ICR review. Since then, with World Bank support, the government's reforms of social assistance programs and pension system are continuing and a poverty alleviation strategy is considered likely to be implemented.

4.10 SPAL did not include a specific institutional development component or any technical assistance. Nevertheless, Bank staff worked closely with government officials during project preparation and implementation, providing technical assistance. Also, technical assistance was provided from ESPP in pension reform, labor market measures and social assistance reforms. Finally, Social Service Departments were established in all Judets. Thus, the *institutional development* rating is *modest*, the same as OED's Evaluation Summary.

4.11 SPAL was consistent with the Bank's Country Assistance Strategy. Indeed, it was an important component of that strategy. Project identification was appropriate, as it contributed immediately to enhancing the social safety net by supporting existing programs and also initiated the medium-term reform of the social protection system. Project preparation was expeditious because the government was strongly committed to establishing a sound social protection system and established joint work groups comprising government officials, Romanian experts and Bank staff to prepare the project. Project appraisal and processing were marginally satisfactory and quick, partly because of the substantial involvement of resident mission staff. The government's capacity to implement some of the short term measures and political and other difficulties in following through with the medium term measures were inadequately assessed, however. SPAL's short-term measures were implemented marginally satisfactorily. While progress was made in designing the medium-term measures, they have not yet been completed. Bank staff involved in the appraisal also supervised the project, working closely with government officials. Intense supervision was instrumental in fairly successful implementation. For these reasons, *Bank and borrower performance is rated satisfactory*, although only marginally so because the implementation of several components of SPAL was delayed, indicating that project preparation, appraisal and implementation were less than satisfactory. OED's Evaluation Summary rated bank and borrower performance as satisfactory.

5. Lessons

5.1 The context is important for drawing lessons from FESAL and SPAL. Senior Bank management took the risk of providing strong support for the new government that came to power after the elections in late 1996. In their estimate, the government was serious about reform, as evidenced by some quick policy changes. Bank management was optimistic that the pace of reform would accelerate substantially. The revised FESAL and SPAL were an important part of the Bank's support for the reform process. When the original FESAL was designed, Bank management required a comprehensive loan covering the gamut of enterprise and financial sector issues. The revised FESAL extended and deepened an already complex loan, anticipating a quicker reform pace. SPAL was designed and appraised very rapidly to provide a temporary safety net for the poor because accelerated reforms were expected to exacerbate poverty. Evidently, Bank management misjudged the government's political commitment for reform and its ability to implement complex conditionality. While the analysis of Romania's situation and direction of reforms was generally appreciated, many commentators believed that the projects neither addressed well the complexity of the reforms nor their implementation. In short, Bank staff did not understand well the political economy of the reform process in Romania.

5.2 More specific lessons emerge from the flawed design of the projects (especially FESAL):

- The design of the SPAL was weighted excessively toward short-term palliatives rather than structural improvements in the safety net.

- Both loans included too many areas of reform and conditions. FESAL started with 27 conditions for the disbursement of four tranches and added 41 conditions after revision. Although SPAL was a simpler, one-tranche operation, it had 23 conditions for disbursement and 18 follow-up measures after disbursement. While maintaining reform linkages is important, adjustment operations should focus on reform segments with a maximum of two tranches disbursed over about one year. Reform linkages can be maintained by careful sequencing or processing several loans simultaneously. The number of conditions should be limited. A few meaningful outcome targets are preferred by borrowers because they retain the discretion over specific measures to achieve those targets. FESAL's follow-up operation, the Private Sector Adjustment Loan (PSAL), was processed at about the same time as the ICR for FESAL. The ICR identified this lesson, but it was disregarded, as PSAL specified 45 conditions for disbursement. Apparently, implementation is proceeding successfully, partly because the conditionality is similar to FESAL's and less demanding. It conforms better with Romania's political commitment and implementation ability.

- Many FESAL and SPAL conditions were linked to processes, such as design and implementation of plans and report preparation, or to outcomes that are difficult to measure, such as "achieving substantial progress" in reform. As a result, monitoring performance became difficult and time consuming. Disbursement conditions should be limited, with easily verifiable outcomes. Unfortunately, PSAL also contains numerous process-oriented conditions and outcomes that are difficult to measure.

- Government ownership, delivery capacity and control over program implementation were inadequate for FESAL, especially for the revised program of 1997. It was negotiated with an outgoing government, and quickly collapsed in the subsequent pressures of a national election. Responsibility for program design and implementation was diffused over many agencies. The new and inexperienced government had little understanding of the scope of its commitment or the capacity needed to deliver the reforms. Bank staff were too involved in preparation, making the project too directive, resulting in an over ambitious program requiring micro-management by a large complement of Bank staff and consultants during implementation. Government ownership and participation were greater for SPAL, and existing programs and structures were used. Several SPAL follow-up actions were delayed, however, partly because the political aspects of implementation were not fully considered. Assurance of government commitment and its ability to follow through on loan conditions is especially important for a one-tranche operation because the Bank loses leverage after disbursement. Working with a high-level counterpart group for project design and implementation is essential for adjustment operations. Ensuring that the program has stakeholder support and the government has capacity to implement it is also crucial. SPAL's success so far is also attributed to a Project Implementation Unit, backed by a senior government minister, that tracks implementation in several ministries.

- Reform programs requiring legal changes must carefully assess the legislative, legal and judicial system's ability to facilitate program implementation. Where impediments exist, the process and system should be strengthened through a separate project.

- Privatization targets should focus on the percentage of state-owned assets actually transferred to private ownership and control.

Interviews:

World Bank Group:

FESAL:
Martin Slough, Task Manager Financial Sector
Khaled Sherif, Task Manager, Follow-up Loan
Arabela Negelescu, Task Manager, Resident Mission
Ruben Lamdany, Participant in FESAL preparation

SPAL:
John Innes, Task Manager, Follow-up Loan
Richard Florescu, Task Manager, Resident Mission
Annamaria Sandi, Resident Mission

Director and Resident Representatives:
Kenneth Lay, Director
Francois Ettori, Resident Representative
Ziad Alahdad, Resident Representative
Farid Dhanji, Deputy Resident Representative

International Finance Corporation:
Liliana Ivascu, Country Coordinator, Washington DC
Ana Maria Mihaescu, Resident Representative

International Monetary Fund

C.M. Watson, Chief for Romania during FESAL's preparation
P. Thompson (with team of five staff), Chief for Romania during FESAL's implementation

Government of Romania

Mr. T. Basescu, Minister of Transport (Implementing follow-on loan)
Mr. F. Georgescu, ex-Minister of Finance
Mr. S. Demetriu, ex-President of SOF
Mr. C. Popa, Deputy Governor, National Bank of Romania
Ms. A. Dragatoiu, Ministry of Labor (social assistance)
Mr. M. Seitan, Pensions
Ms. G. Platon, Ministry of Labor (labor market)
Mr. S. Farmache, Director, Bucharest Stock Exchange
Mr. S. Stoica, President, RASDAQ
Ms. A. Miron, Director SOF (investment bank program)
Ms. C. Gotchu, Director SOF (initial public offer program)

Mr. N. Predoiu, Director SOF (mass privatization program)
Mr. E. Zuirjinschi, Director SOF (privatization)
Mr. Serbotei, Director SOF (restructuring)
Ms. M. Ionescu, Ministry of Finance (enterprise surveillance)
Mr. Kosmescu, Bank Supervision, National Bank of Romania

Other Donors

Mr. A. Lys, European Union
Mr. H. Russell, European Bank for Reconstruction and Development

Basic Data Sheet

SOCIAL PROTECTION ADJUSTMENT LOAN (LOAN 4177-RO)

Key Project Data *(amounts in US$ Thousands)* Not Applicable

Cumulative Estimated and Actual Disbursements *(amount in US$ thousands)*

	FY97	*FY98*	*Total*
Appraisal estimate	50.0	--	50.0
Actual		50.0	50.0
Actual as % of appraisal	--	--	100
Date of final disbursement: September 2, 1997			

Project Dates

	Original	*Actual*
Preparation		01/12 – 02/08/97
Appraisal	04/15/97	04/15/97
Negotiations	05/01/97	05/01/97
Board Presentation	06/03/97	06/03/97
Effectiveness	10/28/97	08/29/97
Completion	12/31/97	12/31/97
Closing date	12/31/97	12/31/97

Staff Inputs (staff weeks)

	Actual	*US$(000)*
Preappraisal	16.9	30.3
Appraisal	10.0	25.0
Negotiations through Board Approval	4.0	7.0
Supervision	7.0	11.0
Completion	0.5	2.1
Total	55.3	75.4

Mission Data

	Date (month/year)	*No. of persons*	*SW in field*	*Specializations represented*	*Performance rating*
To Appraisal Identification Preparation	01/12/97 – 04/15/97	4	9.0	TM, EMT, HR, ECN	
Appraisal through Board Approval	04/15/97– 06/03/97	4	8.0	TM, EMT, HR, ECN	
Supervision	09/97 – 04/98	3	5.0	TM, EMT, HR	S
Completion	06/98		0.5		S

TM: Task Manager; EMT: Employment Training; HR: Human Resources Specialist; ECN: economist

Other Project Data

Borrower/Executing Agency: Government of Romania

RELATED OPERATIONS

Operation	*Loan number*	*Year of Approval*	*Status*
Employment and Social Protection component	Loan 3363	1991	Completed
Employment and Social Protection Project	Loan 3849	1995	Ongoing

Basic Data Sheet

FINANCIAL AND ENTERPRISE SECTOR ADJUSTMENT LOAN (LOAN 3975-0-1-2-RO)

Key Project Data *(amounts in US$ Thousands)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	330.0	233.1	71
Loan amount	280.0	180.0	64
Cofinancing			
- Export-Import Bank of Japan	50.0	50.0	100
Cancellation	-	100.0	0

Cumulative Estimated and Actual Disbursements *(amount in US$ thousands)*

	FY96	*FY97*	*FY98*
Appraisal estimate	100	100	100
Actual	100	80	0
Actual as % of appraisal	100	80	0*
Date of final disbursement: June 17, 1997			

* Balance was cancelled on April 30, 1998.

Project Dates

	Planned	*Actual*
Preparation	01/15/92	04/92
Appraisal	10/94	10/13/94
Negotiations	09/19-25/95	07/18-25/95
Letter of Development Policy	--	11/30/95
Board Presentation	01/11/96	01/18/96
Signing	--	01/19/96
Effectiveness	01/31/96	02/29/96
First Portion Release	--	03/01/96
Floating Portion Release	--	03/01/96
Second Portion Release	--	06/12-17/97
Completion	06/97	04/30/98
Loan Closing	--	04/30/98

Staff Inputs (staff weeks)

	Actual
Preparation to appraisal	347.6
Appraisal	147.8
Negotiations through Board approval	32.6
Supervision	241.3
Completion	3.8
Total	769.3

Mission Data

	Date (month/year)	*Number of Persons*	*Staff days in field*	*Specialization*
Through appraisal	04/92	3	21	
	06/92	2	12	
	09/92	2	18	
	11-12/92	4	12	
	02/93	3	14	
	06/93	2	12	
	10/93	2	18	
	02/94	3	14	
	03/94	4	8	
	05-06/94	3	19	
	06/94	8	21	
	09/94	10	21	
	09-10/94	1	3	
	09-10/94	3	15	
	11/94	1	20	
	01-02/95	2	8	
	01-02/95	1	14	
	04/95	3	7	
Appraisal through	05-06/95	2	19	
Board Approval		1	17	
		1	28	
Supervision	03/96	2	10	Priv. Sector
		1	4	Fin. Sector
	07/96	3	20	Fin. Sector
		2	53	Priv. Sector
	11/96	1	5	Fin. Sector
		1	10	Priv. Sector
	02/97	1	10	Div. Chief
		3	36	Fin. Sector
		3	52	Priv. Sector
		1	8	Econ. – Legal
	05/97	1	4	Div. Chief
		2	17	Fin. Sector
		2	17	Priv. Sector
	12/97	2	22	Fin. Sector
		2	22	Priv. Sector
Completion	05/98	1	12	Fin. Sector

Other Project Data

Borrower/Executing Agency: Government of Romania

RELATED OPERATIONS

Preceding Operations	*Purpose*	*Year of Approval*	*Status*
1. Structural Adjustment Loan (SAL)	To support Government program of macro-economic stabilization	1992	Closed
2. Petroleum Sector Rehabilitation	To restructure and modernize the petroleum and gas sector	1994	Active
3. Industrial Development Project (IDP)	Credit line to finance investment and exports	1994	Active. Restructured to target SME lending
4. Power Sector Rehabilitation	To restructure and modernize the power sector	1995	Active
5. Railways Rehabilitation	To restructure and modernize the railways	1996	Active
6. Bucharest Water Supply	To restructure and modernize water distribution in Bucharest	1996	Active
7. Agriculture Sector Adjustment Loan (ASAL)	To support the program of structural adjustment in agriculture	1997	Active
8. Social Protection Adjustment	To finance severance payments and labor redeployment	1997	Closed
9. Telecommunications	To help privatize telecommunications	1998	Active
Follow-on Operations			
1. Mining Sector Restructuring	Pilot project to finance mine closures	1998	Being implemented
2. Private Sector Institutional Building Loan (PIBL)	Support to development of the SME sector	1999	Board - June 10
3. Private Sector Adjustment Loan (PSAL)	To support program of structural adjustment in the enterprise, utilities and mining, and financial sectors	1999	Board - June 10

MINISTRY OF PUBLIC FINANCE
GENERAL DIRECTORATE FOR
EXTERNAL PUBLIC FINANCE

THE WORLD BANK
Country Evaluation and Regional Relations
Operations Evaluation Department

Attn: Mr. Ruben Lamdany, Manager

Following your letter regarding the Performance Audit Report draft on two World Bank operations in Romania: the Social Protection Adjustment Loan (LN. 4177) and the Financial and Enterprise Sector Adjustment Loan (LN. 3975), we hereby enclose our reviews and comments on the above mentioned loans.

Sincerely,

Valentina Siclovan

General Director

No. 240255/January 24, 2c

Reviews and comments on the World Bank's draft Performance Audit Report on Social Protection Adjustment Loan - SPAL and The Financial and Enterprise Sector Adjustment Loan - FESAL

1. Chapter 1. – Introduction, Subparagraph 1.3. – Macroeconomic

Table 1.1. comprises the ***revised data*** for the selected Economic Indicators, as follows:

	1994	1995	1996	1997	1998
Real GDP Growth (%)	3 9	7.1	3.9	***-6.1***	***-5.4***
CPI (%)					
- end of period	61.7	27.8	56.9	151.4	***40.6***
- period average		***32.3***	***38.8***	***154.8***	***59.1***
Unemployment **(end of period**, %)	***10.9***	***9.5***	***6.5***	***8.9***	***10.4***
General Government Balance (%GDP)					
- includind privatization receipts	***-2.0***	***-2.6***	***-3.8***	***-3.5***	***-3.6***
- excludind privatization receipts	***-2.2***	***-3.4***	***-4.8***	***-5.2***	***-5.5***
Average Interest Rates (%)	78.0	67.0	66.9	138.8	***105.0***
Current Account Balance (% GDP)	-1.7	-4.9	-7.4	***-6.2***	***-7.5***
Debt Service Ratio (%)	9.2	***10.1***	***12.6***	***19.1***	***21.8***
Lei/US$					
- end of period	***1767***	***2578***	***4035***	***8023***	***10951***
REER (e.o.p. CPI based 91=100)	106	93	101	119	

2. Chapter 1 – Introduction, Subparagraph 1.5 – *Enterprise and finance sectors*

By the end of 1993, the private sector generated about ***35%*** of economic activity (34.8% of GDP), mostly in services and private agriculture.

3. Chapter 1 – Introduction, Subparagraph 1.6

By 1997, ***thirty-seven*** licensed banks were operating, including seven state owned banks. (forty-five licensed banks were operating by ***1998***).

4. Chapter 3 - *Implementation Experience (FESAL)*, paragraph 3.3.

The Stand-by Arrangement (approved by the IMF Board in April 1997) lapsed in May 1998 with only ***two*** (SDR 120.60 million) out of five tranches released.

5. Chapter 3 - *Implementation Experience (SPAL)*, paragraph 3.13 – *Measures to improve income transfer programs for vulnerable groups*
The draft Law regarding the Minimum Income Guarantee (MIG) was approved by the Government on December 2000 and submitted to the Parliament for approval.

6. Chapter 3 - *Implementation Experience (SPAL)*, paragraph 3.15 – *Improving the public pension system and introducing a private pension system*
The Pension Law drafted in 1997 was revised and improved by taking into account the Bank's comments and recommendations. The current version, acceptable to the Bank, was approved in 2000 (Law no. 19/2000) and is to enter into force on April 1st, 2001. The Law provided for the establishment of the National Pension House and Other Social Insurance Rights, having the responsibility of managing the social insurance budget.

7. Chapter 3 - Implementation Experience (SPAL), paragraph 3.17 – *Designing a poverty alleviation strategy*
The Government of Romania's Medium Term Economic Strategy, presented to Brussels in March 2000, provides for the setting-up of a monitoring department for poverty alleviation policies, subordinated to the Prime Minister (the National Commission for Poverty Alleviation still functions under the President chairmanship). Moreover, within the Social Development Fund project, co-financed by the World Bank and the Council of Europe Development Bank, The Romanian Fund for Social Development was established under the Government's authority, pursuing the poverty alleviation through grants for poor communities and less favorite groups.

8. FESAL overall assessment:
Although FESAL successful implementation was not achieved in many respects and the performance of both the Bank and the Romanian Government (as Borrower) was considered unsatisfactory, FESAL, however, paved the way for a more successful structural adjustment program – PSAL. In spite of a higher number of conditions (***51 conditions*** and a number of benchmarks), PSAL achieved or exceeded objectives in virtually all cases, (as noticed by the Bank in its ICR), due to a more adequate, demanding and change-responding economic background and to a stronger commitment of the Romanian authorities. This favourable achievements are expected to be further enforced and extended through a second PSAL program.