

NATIONAL REPORT

Romania



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STATE-OWNED COMPANIES IN ROMANIA

PREVENTING CORRUPTION, CLIENTELISM AND STATE CAPTURE

- COUNTRY REPORT -

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Summary

Romania is currently the country with the largest number of state-owned companies in Europe. The government is a majority shareholder in approximately 250 companies, and the local authorities own over 1,100 companies. The exaggerated size of the public sector, the very large number of state-owned companies and their scattered distribution all across Romania make monitoring difficult and contribute to avoiding public scrutiny, creating opportunities for corruption and clientelism.

Poor management and corruption in state-owned companies means both wasting public money but also distorting competition on some markets, channelling public resources to corrupt or *clientelistic* networks. The activity of state-owned companies also has an impact on various markets, and poor administration of these companies is a loss in economic terms and it distorts competition.

The main conclusions of the Report are:

- 1) There has been a significant improvement of the corporate governance legal framework for state-owned companies. The legislation observes the principles of the Organisation for Economic Cooperation and Development (OECD) and even if it was not fully applied, it resulted in significant improvements, at least for some larger companies, in particular for those under the control of the central administration. At the level of local (utility) companies, both legislation enforcement and performance are lagging behind, when compared to those at central level.
- 2) The positive effect of the general corporate governance framework was amplified by sectoral reforms, such as: liberalisation and increase in transparency in the energy sector, listing of some companies at the stock exchange, strengthening of certain regulations, tariff reforms for utilities - many under the pressure of the European Commission or the IMF.
- 3) There is a clear correlation between the quality of the corporate governance framework and the "*performance*" of state-owned companies. With the improvement of the corporate governance framework in 2011, state-owned companies performed better. For instance, in 2016 companies in the "*Fondul Proprietatea*" portfolio distributed to the state budget dividends 12 times higher than before the adoption of G.E.O. 109/2011 - from 117 million lei to 1.4 billion lei. Performance differs from sector to sector, depending on the strictness with which the corporate governance framework was enforced and depending on sectoral reforms. For example, the performance of *Hidroelectrica* improved significantly with the energy reforms and with the increase in transparency regarding the activity of the company, but the performance remained low in the case of *CNADNR*, where no corporate governance framework was enforced, and where there were no sectoral reforms.
- 4) The experts interviewed were of the opinion that the minority shareholder can be a "*change agent*" or a "*pressure factor*", which could determine observance of corporate governance rules within state-owned companies.
- 5) The success of anti-corruption prosecutors in several high-profile cases played a positive role and discouraged some practices such as unprofitable procurement

(*Romsilva, CFR*) or undervalued sale (*Romgaz, Hidroelectrica*). The activity of the National Integrity Agency (ANI) discouraged conflicts of interests and incompatibilities. The National Anticorruption Strategy for 2016-2020 included corruption prevention measures in state-owned companies. But there are still vulnerabilities in the administrative control mechanisms (the responsibility of sectoral ministries, the activity of the Court of Accounts etc.).

- 6) As of 2017, there is a significant risk for most of the achievements to be lost again. Both the corporate governance framework and some sectoral reforms are taking important steps back. Law 111/2016 is not enforced in the majority of state-owned that were analysed. The Ministry of Public Finance has not published the analysis of the situation of state-owned companies for 2016 and it applies no sanctions for non-observance of Law 111/2016, although this law is systematically infringed, for example, by "*turning interim management into permanent management*" in state-owned companies. There is an attempt to amend Law 111/2016 in the Parliament, to exempt dozens of SOEs from the application of the corporate governance framework.
- 7) State-owned companies, especially those in the energy sector, were forced to distribute to the state a minimum of 90% of their net profit (and not a minimum of 50%, as provided by the law) and, moreover, they were forced to distribute, as additional dividends, the undistributed profit of the previous years, established as financial reserve. This had a significant impact on their investment capacity and on their long-term development - including on projects essential to energy security or crucial for meeting commitments to the EU (e.g.: interconnections in the energy sector).
- 8) Two other matters with a potential major effect on the governance of state-owned companies are the uncertainties related to the enforcement of legislation on public procurement (excluding sectoral contracts) and the recent set-up by the Bucharest authorities or by other municipalities of many new state-owned companies, with unclear scope, status and applicable legislation. We could not make a thorough analysis in our report regarding the situation of the 22 municipal companies undergoing incorporation by the Bucharest City Hall. Based on the information we have so far, we would like to raise attention with regard to poor governance and political clientelism. These companies would get budgets of approximately EUR 130 million - more than 10% of the budget of the Capital city - without clear justification of the reason for their set-up, their duties, the criteria of appointment for the management, how they would be monitored, and in disregard of the law on transparent decision-making at the time of their incorporation. We noticed that appointment of managers in all these companies is made exclusively based on their close relationship with the mayor of Bucharest and without any proof of their training in the scope of business of these new companies. At the same time, the City Hall's investments practically came to a stop in 2017, awaiting the set-up of these companies which would manage huge amounts of money.

In conclusion, we request abandoning the initiatives to amend Law 111/2016 for the approval of G.E.O. 109/2011, and the immediate and integral enforcement of this Law, both to existing state-owned companies and to new companies undergoing incorporation by local authorities.

Aside from the issue of setting up new state-owned companies, the public agenda should re-focus on the inflated size of the state sector in the Romanian economy. This must be done by defining clear shareholding policies for the state - by defining the notion of Service of general economic interest - but also, by indicating - for each company - the reasons justifying state ownership (through local or central authorities) of shares. This should be specified in the Letter of expectations, which is a provision introduced by Law 111/2016.

Reducing the state sector by privatisation, issuing and selling shares, preserving and applying the principles of corporate governance in all state-owned companies whose existence is justified objectively, decreasing the number of new companies set up by local public authorities – all these measures will lead to an improvement of their economic performance and also, as a side effect, to mitigating corruption.

State-owned companies in Romania

Preventing corruption, clientelism and state capture

- Country Report -

State capture is one of Romania's main governance problems throughout the post-communist period. During the transition to a market economy, with extended state assets, the liberalisation and privatisation process was often marked by political interventions and use of public assets for personal gain. Beyond the numerous acts of corruption, systemic capture of state-owned companies (SOCs) in Romania has affected the economic performance of these companies, as well as their perspective of privatisation in optimal conditions. And, to make matters worse, Romania continues to be the country with the largest number of state-owned enterprises in Europe.

From the perspective of the European Union, the problem of corporate governance of state-owned companies in Romania is a priority. The European Commission recognised in 2016 the *"substantial progress"* made in terms of legislation, but the implementation of these procedures is still a weakness: *"However, delays in the appointment of professional managers raise concern on further implementation."*¹

During 2017, there was legislative pressure to exempt dozens of companies from the constraints of corporate governance, raising concerns about the politicisation of their management. Even if competitive selection of managers and members of the board of administration was not always a solution to increase efficiency and transparency, it was an important step in achieving quality corporate governance.

In this report, we will analyse the situation of SOCs, the development of the legal framework, the enforcement of the law, and we will provide examples of effects of a governance framework on the good operation of public companies.

This report is based on mixed data collection methodology. The project *"State-Owned Companies - Preventing Corruption and State Capture"* (SOESC), financed by the European Commission was the first opportunity to collect comparative data about state capture in state-owned companies in four members states of the European Union (EU). Bulgaria, the Czech Republic, Italy and Romania. This report reflects the results of the research in the Romania case study.

The report is an attempt to measure the extent of corruption and clientelism in state-owned companies in Romania. It is obvious that there is no indicator to measure in a single figure the overall level of corruption or clientelism in state-owned companies, but capture mechanism can be monitored and a framework can be designed to monitor the evolution in time of the level of corruption and clientelism.

There are several levels of analysis taken into account in this report:

1. Recommendation of the Council concerning Romania's national reform program for 2017, Art. 25, June 2017, https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations_-_romania-ro.pdf

Corruption punishable under the criminal code requires sufficient evidence to lead to a conviction “beyond reasonable doubt”. Despite some real success of justice in Romania, criminal sentences will never be enough to eliminate systemic corruption in its entirety - although it may discourage it - for the mere reason that there will never be valid evidence for all corruption cases to stand trial.

Next, there are the signs of corruption, which are not enough to lead to a conviction in a criminal trial. Signs of corruption identified in journalistic investigations or experts’ analysis reflect institutional weaknesses, as well as deficiencies of the monitoring or administrative control mechanisms which could be corrected, thus mitigating corruption opportunities.

Eventually, poor administration of state-owned companies can lead to financial losses or losses of economic opportunities, to insufficiencies that are not, in fact, acts of corruption, but they create opportunities for corruption, clientelism, or even state capture. In this respect, the report analyses the general framework for corporate governance or the sectoral reforms which creates accountability for the actors with a role in the proper operation of these companies.

Therefore, in order to measure clientelism and corruption in state-owned companies, we start from the broadest level, presenting the evolution of the general corporate governance framework in Romania, both “*on paper*” and in terms of how it was put into practice. We show that there is a fairly clear correlation between the “*performance*” of state-owned companies and the quality of this general framework - in relation to which we are making some recommendations. To illustrate this correlation, we made a selection of state-owned companies in various sectors, covering the main areas and topics and providing a glance into the most frequent mechanisms of clientelism and state capture. For these companies, we present cases of corruption and clientelism proven in court, in analyses or in journalistic investigations, through case studies. We support the idea that, by improving the general corporate governance framework – so, both the laws and the administrative control mechanism - corruption opportunities can be reduced substantially.

Research methodology

The project focused on analysing clientelism, poor governance and corruption in state-owned companies in four member states of the EU - Romania, Bulgaria, the Czech Republic and Italy - which are characterised by a history of economic interventionism by the state. This study refers to companies in Romania. This research involved using several quantitative and qualitative methods:

- 1) **A desk-research of the relevant documents:** the legislation in force (Government Emergency Ordinance 109/2011, Law 111/2016, but also sectoral laws), information obtained based on the Law on access to public interest information (Law 544/2001), information available in the public space concerning the budgets, enforcement of the law on corporate governance, financial indicators of state-owned companies, other specialty studies (monitoring reports from the Ministry of Public Finance, reports of the IMF and of the World Bank, analyses carried out by the Bucharest Stock Exchange, *Fondul Proprietatea* etc.), control reports (Court of Accounts, Competition Council), indictments by prosecution offices and journalistic investigations.
- 2) **In-depth interviews with relevant experts:** six in-depth interviews with relevant experts in communications, energy, environment and transport, carried out in May 2017.
- 3) **On-line research with relevant experts:** a database was created with 245 high-level experts in communications, energy, environment and transport (board of administration members, ministries, state secretaries, consultants from the private sector etc.) In April-May 2017, 41 experts response - a response rate representing a sample according to the questionnaires.²
- 4) **The analysis of the financial data and of all proxy type indicators of the selected companies** to create indicators to help us measure *objectively* (beyond perceptions) to what extent the amendments to the general corporate governance framework resulted in changes in the performance of the companies selected for the study.

2. The questionnaire applied in all countries included in the project follows some recent analyses - the Political Patronage Index (PPI) developed by Kopecky et al 2012/2016. The results of this research, like all exploratory research results, are not representative at national level. The featured quotes are not intended to represent the opinion of all experts in the sectors analysed.

1. GENERAL ANALYSIS OF THE FRAMEWORK OF OPERATION OF STATE-OWNED COMPANIES

With privatisations, reforms and foreign investment much delayed in the 90s, Romania is currently the country with the largest number of state-owned companies in Europe.³ The government is a majority shareholder in approximately 250 companies, and the local authorities own over 1,100 companies.⁴ State-owned companies are responsible for approximately 40% of the turnover in gas & energy and in postal services and for over 20% in transport.⁵

The exaggerated size of the state-owned sector raises enormous challenges for control authorities in terms of monitoring, and makes it easy to elude public scrutiny, providing opportunities for corruption and clientelism.

We will analyse the response of the authorities: the legal framework of corporate governance, beginning with G.E.O. 109/2011, adopted by Law 111/2011 and supplemented with application norms GD 722/2016, the institutional framework, from the perspective of the monitoring mechanism for state-owned companies, and we will list the main challenges and potential solutions resulting from the research.

In parallel with the legislative consolidation, in some sectors, for example the energy sector, significant sectoral reforms were rolled out after 2011, while in other sectors, for instance transport, no such reforms took place. The legislation was enforced to different degrees in each sector - companies under more strict monitoring by international partners enjoyed more transparent and more competitive selections of professional managers.

The activity carried out by National Anticorruption Directorate and ANI played a significant role. Trials with high profile convictions discouraged corruption and increased awareness about the need for reforms.

Unfortunately, after steady improvement of the general governance framework, in 2017 we notice substantial regressions both in terms of the governance legislation and its application, but also in terms of the sectoral reforms (for instance, weakening of the energy regulator - ANRE - by political appointments and pressure by the Parliament through investigation committees, by forcing energy state-owned companies to distribute dividends in advance to cover the gaps in the state budget etc.) Some institutions, such as ANI, are showing signs of slow-down, while others, such as the Court of Accounts, are becoming more and more politicised and more de-professionalised, as reflected by the recent appointments in management of this institution.⁶

A diagram of the evolution of the corporate governance framework in a broader sense - the actual law, the structural sectoral reforms and the administrative and criminal

3. Elisabetta Capannelli, World Bank country manager for Romania and Hungary, 3 March 2017, "Romania should continue reforming state-owned enterprises to boost its growth" <http://blogs.worldbank.org/europeandcentralasia/ro/romania-should-continue-reform-its-state-owned-enterprises-enhance-growth>

4. "The European Commission on Romanian state-owned enterprises: Significant losses, poor performance, politicised management" *Hotnews*, 1 February 2015 <http://economie.hotnews.ro/stiri-companii-19261103-comisia-europeana-despre-companiile-stat-romanesti-pierderi-mari-performanta-scazuta-management-politizat.htm>

5.

6. <http://www.hotnews.ro/stiri-politic-22049248-mihai-busuioc-noul-sef-curtii-conturi.htm>

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Reforma cadrului GC	nimic în afară de legea companiilor comerciale				UIG 109 selecție competitivă manageri					L111 cadru general GC	
				FP acționar minoritar – Franklin Templeton			Listări bursă			SNA prevenție	
Reforme structurale	regres de la reforme sectoriale alocate UE			program structural FMI		Reforme sectoriale: liberalizare, ajutor de stat, reglementatori				regres de la reforme	
Sanțiuni administrative		ANI devine activă							ANI mai puțin activ		
Sanțiuni penale					DNA finalizează cazuri majore cu condamnări definitive				DNA mai puține dosare companii stat		

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our opinion, is the main problem of the corporate governance framework in Romania at this time. It was necessary to clearly define the reasons behind the state's involvement concerning the assets owned by it and administered by companies or autonomous administrations.⁹

The Law 111/2016 brought clear state shareholding policy elements, in particular by introducing a "*letter of expectations*"¹⁰ with regard to the requirements of the state as owner (control authority) with regard to each company. By introducing a Letter of expectations and performance criteria and by correlating the mandate contracts with these criteria, Law 111/2016 sets clear and coherent responsibilities for the state as owner, for supervisory councils and for company administrators/ managers.¹¹

In the current legislative context, the state becomes an active shareholder in the development of the strategy and objectives of state-owned companies. Strategic governments objectives can be easily and naturally correlated with the activity objectives of state-owned companies.

Their interference in the strategic framework can create additional opportunities of state capture, when appointments are made exclusively based on political criteria. The explicit subordination of development objectives of state-owned companies to the development vision of the public control authority can generate inefficiency and poor management of the company's resources. On the other hand, correlating public governance objectives with corporate governance objectives may decrease the incidence of capture by private agents. The public control authority can have objective and substantiated interventions to correct deficiencies and to ensure the path of activities undertaken according to the law, in the Letter of Expectations or in the Administration Plan.

"The main trait of state-owned companies is that they take the state part more serious than the company part. The attitude was always one where they viewed themselves as extraordinary, different from regular companies. Which is completely wrong. One obvious example is RAAPPS, which is an autonomous administration, a party-related company, for all parties after 1989, kept exactly as it was before 1989, with the same organisation and the same activities" (**former ministry**)

"Last year we started an analysis in the ministry concerning the financial statements and results of subordinated companies. This need to carry out analyses in various stages is linked to better supervisory: when a budget increase is requested, or when we approve their budget and we ask to see future development plans. When it was time to pay dividends, we sent some companies home, and we took the risk, we said: «I don't want you to give me all your profits, because it means

9. The state may own companies to obtain dividends for the budget, but, mostly, for the provision of public services (such as building motorways or administering forests), or with mixed objectives - both commercial, and to provide public services.

10. According to the new Art. 2 of Law 111/2016, the letter of expectations is defined as a "working document through which the public supervisory authority (...) sets the performance expected of the administration and management bodies of the public enterprise, as well as the policy of the public supervisory authority concerning public enterprises with specific obligations related to providing a public service, for a period of at least 4 years."

11. Therefore, a company has a Plan of Administration, approved by the General Assembly of the Shareholders (AGA), after it is previously analysed by the Board of Administration (BA). The plan has both an administration and a management component. The administration component is carried out by the BA - which is accountable for it, and the management component is carried out by the directors - who are accountable for it. Both components must be coherent and consistent with the Letter of expectations. Both have clear financial and non-financial performance indicators, which are found even in the mandate contracts of the members of the BA, and those of the managers. AGA monitors the performance of the BA, the BA monitors the performance of the directors in a formalised manner, with deadlines, criteria and sanctions.

you're not going to develop as a company»." **(former secretary of state)**

Although in practice the provisions of Law 111/2016 have not been implemented yet with regard to the achievement of this strategic governance framework of state-owned companies, this type of documentation making a clear delimitation of the objectives of the state as a shareholder can ensure that public interests are reached, and can ensure a good relationship with the minority shareholders when applicable.

"Last year, we've been under the impression that the members in the management of the companies would leave certain decisions for the ministry several times, in order for them not to have to do it themselves. We tried to leave the administrative part for them, and we told them to decide in the BA what needs to be done and to come up with solutions. If they required support from a legislative perspective, we stepped in and that was the support we gave them." **(former secretary of state)**

"Larger companies are used to being protected, to receiving political support. And there is one more problem. Management changes are very frequent, and mistakes can occur but to lack of knowledge or because the management is of a modest quality. They don't think in terms of profit. They want the state to give them money, they want the state to buy them a train - for example. So, I don't think the management is very sophisticated." **(high-ranking civil servant)**

"We can ask ourselves if the state is efficient or not. No, it's not efficient. It is, basically, a cumbersome and less efficient administrator. Definitely, less efficient than the private sector. On the other hand, I believe that the state also has some instruments and I think it also succeeds in protecting - at least in the energy sector - strategic interests, and, in a way, that's its role. I believe in the role of the state in state-owned companies and I believe very much that the state should play an important role in certain areas. I doesn't mean we can't do it differently, but I believe in this area, in our geopolitical context, it is very good." **(former ministry)**

Law 111/2016 introduces explicit provisions to protect the rights of all minority shareholders¹², centralised supervisory of all state-owned companies is provided through the Ministry of Public Finance¹³, clear terms and sanctions are provided for non-observance or for delays¹⁴ and it introduces ethics codes and monitoring systems for conflicts of interests.

1.1.2. Evaluation of the quality of corporate governance legislation

Most interviewed experts consider that the general legal framework on state-owned companies is of average quality (45%) or of good quality (25%). Just a third of the respondents consider the legal framework limited or very limited (23%, respectively

12. All shareholders holding over 5% have access to any date on the company, and all shareholders are informed about all transactions over EUR 100,000.

13. Even if in G.E.O. 109/2011 the Ministry of Public Finance has a representative in the BAs, in Law 111/2016 it becomes a legal requirement for the MPF to collect information and data from all these companies, which is normal, given that the money running through state-owned companies is public money.

14. If the directors or administrators do not reach their indicators, their salary drops proportionally to the non-observance of these indicators. Directors and administrators can only be dismissed if they are in serious infringement of the mandate contract, not due to a failure to meet indicators, which is a beneficial measure, since it does not allow arbitrary dismissal of managers selected competitively for "not meeting the administration plan".

8%). No respondents believed that the general legal framework in Romania is very good.

In terms of the sectoral legal framework, in the field of work of the experts interviewed, there are insignificant differences to the general evaluation. It should be noted that 3% of the experts interviewed believe that the specific sectoral provisions are very good, while 24% consider that they are good.

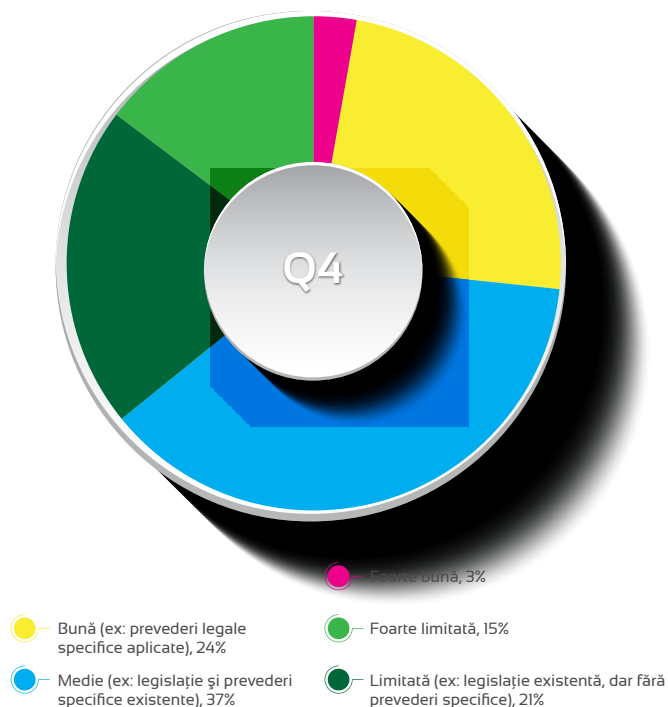
Evaluation of the quality of the legal framework

Source: expert questionnaire

The diagnosis of the experts it that there is specific legislation, but it is applied only partially or not at all.

Evaluation of the quality of the legal framework at sectoral level

Q4: Cum evaluați calitatea cadrului legislativ privind companiile de stat din sectorul (X) în ceea ce privește prevederile specifice sectoriale



Source: expert questionnaire

1.1.3. Evaluation of the implementation of corporate governance legislation

Because of political instability, frequent governmental changes, and the lack of political will, the provisions concerning recruitment and selection of managers in state-owned companies were not applied as provided by the law. The selection by the ministries of professional managers was influenced by political interests, as reflected by the interviews with former and current decision makers participating in the implementation of the above-mentioned legal framework.

Rigorous selection of professional management was limited. Political changes often lead to changes in the management of the company and to infringement of the provisions of corporate governance by imposing or extending interim management - which was more or less justified.

“The impact of G.E.O. 109 manifested itself in two phases. The first, immediately after its adoption, when there was a fairly strong attempt to implement this ordinance and to make the recruitments. What followed was a regression, in which the political factor tried to minimise as much as possible the effects of the ordinance in order to ensure continued control over the companies.” **(former BA member)**

“There were structural problems, and I believe it proves the lack of strong political will to restructure and reform these companies. The ordinance on corporate governance can only have limited effects in terms of stopping discretionary appointments of political clientele. It requires standards and procedures being harmonised with those in the private sector.” **(former BA member)**

“The idea of the IMF was to introduce professional management and for us not to touch it. This idea of “us not touching it” clearly did not work! I don’t know how well these people were chosen, but definitely the idea was to give them a few years. When the Government changed, they each brought changes, they installed interim managers.” **(expert, high-ranking civil servant)**

After the initial enthusiasm (triggered mostly by the strict monitoring of the IMF at the beginning of the process in 2009), the political will to select professional managers for state-owned companies diminished considerably, and in this last year the process was stopped altogether.

1.2. MECHANISMS FOR MONITORING STATE-OWNED COMPANIES

1.2.1. General framework

State-owned companies have different objectives - from service provision to producing public goods (with state budget financing), to commercial activities conducted for profit. The legislative process in 2016 entails providing a clear definition of these objectives by the supervisory public authority in a Letter of exceptions, building proper performance indicators for every company and correlating contractual obligations of managers and administrators of state-owned companies with indicators and the general mission of the state-owned company.¹⁵

The monitoring of state-owned companies is carried out at two levels:

- external monitoring systems, at the level of the Ministry of Public Finance and the Public Control Authority (APT) - in most cases, the line ministries);
- internal monitoring systems, established in the Boards of Administration and the Supervisory Council.

The Ministry of Public Finance monitors state-owned companies and the way in which public control authorities implements corporate governance and impose sanctions.

According to the law, a public control authority that does not select its management or its administrators based on competitive criteria within the legal deadline, should be fined. Unfortunately, in 2017, control authorities are infringing the law without being sanctioned by the Ministry of Public Finance - as was the case of companies such as Transelectrica, Nuclearelectrica etc. Although the mandates of the management selected based on competitive and transparent criteria G.E.O. 109/2011 reached the end, interim managers were appointed in disregard of the competitive selection requirements and they are still in office beyond the deadline provided by the law. This practice allowed politicisation of the companies in 2017.

The public control authority is responsible for setting the results framework to monitor and measure performance of state-owned companies. At the level of the control authority, there are two monitoring systems:

- monitoring performance indicators (financial and non-financial), respectively the remuneration of the management based on performance evaluation before appointing an administrator or a director in the new mandate;
- monitoring the implementation of legislation on corporate governance, for example non-financial performance indicators concerning the establishment and period review of the strategy, of the risk management plan or of the transparency level and the quality of inter-institutional and public communication.

Both the quality and the schedule - the timing - can be subject to monitoring (for example: how long did it take to complete the risk management plan after the appointment).

¹⁵. To draw up these documents, the Ministry of Public Finances drafted a *Guide on the integrated management of state participants in the economy* <https://goo.gl/qg6pUh>

1.2.2. Performance indicators

Performance indicators are provided as objective monitoring mechanisms and are established in the Administration plan, carried out partially by the BA (administration component) and partially by the directors (management component). The flexible remuneration of the directors and of BA members depends on the achievement of the performance indicators negotiated with the public control authority according to the Letter of expectations.

The financial performance indicators are used to determine the efficiency of use of resources to generate revenue, to cover costs and to obtain profit. The cash flow, the costs, the debt, the investment and the revenues are financial indicators applicable to all types of state-owned companies. Profitability can be used as performance indicator only in the case of commercial public enterprises.

Non-financial performance indicators show how well the public enterprise is using its resources, being usually derived from the enterprise's policy: customer satisfaction or employee capacity, market share, quality of services/ products etc. At the level of all state-owned companies non-financial performance indicators can be used which characterise the quality of corporate governance: if the strategy of the enterprise is developed and approved in a timely manner, timely revision and reporting of progress of its strategy, timely set-up, revision and reporting of performance indicators, establishing risk management policies, timely revision of risk management, observance of the transparency and communication policies, evaluating and reporting the performance of the administrator etc.

Often there are the same performance indicators for the mandate of the board of administration and for the mandate of the general director. This situation makes it difficult to make objective decisions on sanctions for poor performance by the management of a company.

However, more than half of the experts consulted believe that public control authorities sanctioned the lack of performance and the poor management of public resources in state-owned companies. The most eloquent examples provided in this sense are from the energy sector (Hidroelectrica, Complexul Energetic Oltenia, Romgaz) and from the transport sector (CNADNR, CFR Marfa, Port of Constanta)

According to the survey among experts, in all analysed sectors and in most state-owned companies there is summary reporting of the performance indicators.

There is high level of procedural inconsistency, both in terms of the reporting and with regard to the monitoring and evaluation procedures. Experts point out that practices continue to vary considerably between sectors, different public control authorities and state-owned companies. This heterogeneity is not consistent with the legal provisions in force. On the other hand, these indicators are evaluated asymmetrically, some performance indicators being perceived as irrelevant for the field of activity or specific circumstances of certain companies.

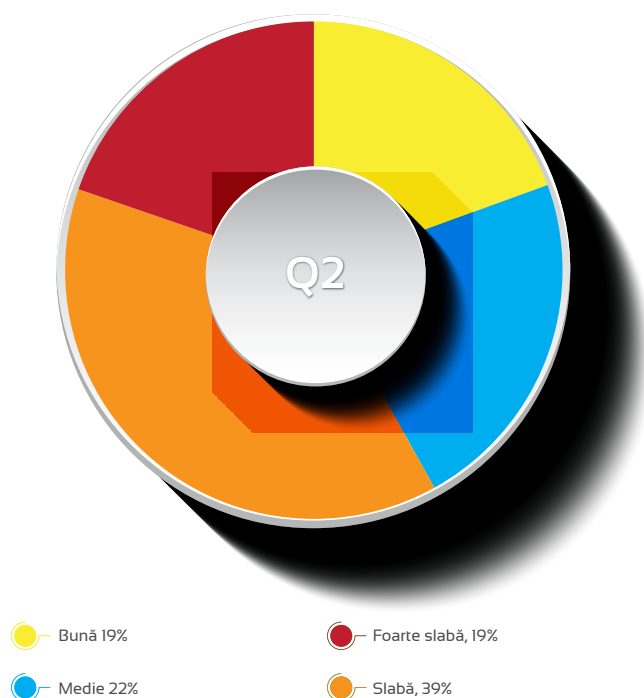
Since performance indicators are not selected objectively, with the clear purpose of achieving permanent monitoring, some respondents perceive them as political tools to justify the decisions of public control authorities.

1.2.3. Evaluation of the efficiency of monitoring mechanisms

Only 41% of the experts consulted believe that the efficiency of the monitoring mechanisms for state-owned companies is average (22%) or good (19%). These figures are significantly below their appreciation of the quality of the corporate governance legal framework: 45% consider it average and 25% consider it good.

Evaluation of the efficiency of monitoring mechanisms

Q2: Cum caracterizați eficiența mecanismelor de monitorizare pentru companiile de stat din România?



Source: expert questionnaire

Monitoring mechanisms for state-owned companies in Romania are perceived by experts as either inefficient or politicised. The absence or the deficit of monitoring mechanism explain why the legal framework was considered insufficiently implemented or applied.

The efficiency of these monitoring mechanisms is low, in the absence of clear systems to sanction the deficiencies. The main sanction is dismissal of the executive or non-executive management.

High-ranking officials interviewed stated that monitoring instruments are either under-used - the reporting sent by each company to the MPF are not evaluated and used for feedback) - or there are flawed by political influence. The most frequently situations are political appointments in the control bodies of the ministries of the control authority.

"I don't want to sound patronising, but in my experience, there were real monitoring and control mechanisms, but let's not forget that when politicians are guiding certain directions, control is subordinated one way or another, since even the control body is politically appointed." (former BA member)

In Romania, there is currently serious shortage of human resources in the monitoring process: many of the people in charge with such activities are not specialised in this field or lack the specific competences, and, on the other hand, the organisational charts of the institutions create constraints in terms of indicating certain individuals for monitoring.

1.3. THE CHALLENGES OF CORPORATE GOVERNANCE, GOOD PRACTICES AND POTENTIAL SOLUTIONS

Expert consultations revealed several problems which corporate governance is faced with: human resources without training or expertise in the field, instability at decision-making level or the economic-financial situation. These problems derive from the area of political mandate of the decision-making political factor and the predominance of short term perspectives.

On a legislative level, the conclusion was that it is necessary to clarify the notion of "service of general economic interest" which can justify the need for state involvement to provide these economic activities which could not be provided by the free market.

During the interviews based on the questionnaires drafted at the beginning of the year, the legislative developments in the Parliament brought on a new and serious threat - the possibility of emptying corporate governance of its content.

1.3.1. Maintaining and strict enforcement of corporate governance legislation

Recent developments indicate that the political consensus displayed last year - upon the adoption of Law 111/2016 to approve G.E.O. 109/2011 - was deceitful. Although considered by the European Commission as being in line with "good international practices", the framework of corporate governance was under serious threat in 2017, both through attempts of legislative amendments and through non-enforcement of the existent legislation.¹⁶

¹⁶. Subjecting to the final vote: Draft legislation for the approval of G.E.O. 109/2011 on corporate governance of public enterprises PL-x 47/2012

In the spring of 2017, a review process was launched, which led to the proposal to exempt dozens of state-owned companies from the application of the requirements of corporate governance - including RAAPPS, RA Official Gazette, TAROM, IOR, Complexul Energetic Oltenia, naval yards, all water companies. The amendment argues that "these economic operators, aside from their economy activity carried out in market conditions, must ensure mobility or war duties, irrespective of the profitability of these activities."¹⁷ In the Chamber of Deputies there was a proposal to empower the Executive to exempt certain companies from the provisions of G.E.O. 109/2011 by Government Decision.¹⁸

On the other hand, in terms of the application of the existent legislation, in 2017 the exception which permitted control authorities to appoint interim directors or administrators¹⁹ became a general rule.²⁰

Another concern is related to the lack of data transparency. Some of these companies do not even publish annual reports, although this is required by the law.

In 2016, some of the data on state-owned companies was centralised by the MPF and are available on-line.²¹ In 2017, there is no such data available about these companies. The annual end-of-year evaluation for 2016 on the situation of state-owned companies was not carried out either, although the Ministry of Public Finance had been publishing it since the approval of G.E.O. 109/2011. Also, only part of the state-owned companies have Letters of expectations, although a year passed since the publication of the methodological norms.

1.3.2. Defining the concept of services of general economic interest - SGEI

There needs to be a clear definition of what "public economic service" is or "service of general economic interest" is. In European practice, a service of general economic interest (SGEI) refers to economic activities that would not be supplied if there were no public interventions. The concept of state aid is built around this concept.²² The state must finance such economic services clearly and transparently, and they can be provided by a state-owned company or by a private one.

The link between SGEI and state-owned companies

Some SGEIs can be provided also by private providers, with financing from the state budget. For example, a passenger railway transport company must receive the same subsidy per passenger/ km, irrespective whether it is state-owned -

(adopted)<http://www.cdep.ro/pls/steno/steno2015.stenograma?ids=7670&idm=2,022>

17. The Romanian Senate. Additional joint report on the legislative proposal of amendment of Paragraph (3) of Art. 1 of G.E.O. 109/2011 <https://senat.ro/legis/PDF/2017/17L094SI.pdf>

18. Cristian GHINEA (USR): After them, comes the flood. What have they done with state-owned companies? 21 September 2017 <http://www.justitiecurata.ro/ghinea-usr-companiile-de-stat/>

19. Two new articles were added to Law 111/2016 approving G.E.O. 109/2011, which provide for the possibility of appointing "interim directors" and "interim administrator" for 4 months, until the completion of the selection procedure. If the procedure is suspended or cancelled, the interim mandates continue until the appointment of a new director or administrator

20. The Trojan horse. About the interim mandates of corporate governance, Hotnews, 12 October 2017, <http://economie.hotnews.ro/stiri-companii-22050233-calul-troian-sau-despre-interimatele-guvernantei-corporative.htm>

21. <http://data.gov.ro/dataset?q=companii>

22. http://ec.europa.eu/competition/state_aid/overview/public_services_en.html

CFR Călători - or private - *Regiotrans*.

Some state-owned companies carry out purely commercial activities, without any public economic service features, such as *Oltchim*, *Romgaz* or *Antibiotice Iasi* - all companies operating in fully competitive sectors. For these companies, first of all, the issue is whether state ownership is justified or if they could be privatised. To increase the responsibility of the companies it is strictly necessary to define the objectives of the company and to correlate performance thereto.

In Romania, even if the corporate governance framework is improved, the problem of defining SGEs remains. The legislation in the field is fragmented (there are different laws for municipal services - transport, energy, etc.) and many cases are not covered by the law. There are no records of public economic services provided at national level. Of the Letter of expectations indicates the justification behind share ownership in each company, defining the Service of general economic interest is essential for the global definition of a shareholding policy of the state, meant to explain state involvement in these companies.

Most state-owned companies are not purely commercial, but they have - to a variable extent - some public service features. Thus, state-owned companies often have conflictual objectives; in order to hold a manager accountable for the financial results of a company, it must not finance public services from commercial profits; and public service must be financed by the state, defined as such in a law which makes it clear which public services the state wants to provide and the subsidy must be verified by the Parliament during the approval of public budgets.

1.3.3. Monitoring newly established companies set up by the local public administration

The incorporation of new state-owned companies by local authorities should be closely monitored and studied, not just in terms of the application of corporate governance principles. Setting up such companies without objective justification should be in the attention of the Competition Council because it is a return in the past, contrary to the spirit of the Constitution, which defines Romania as a "market economy, based on free initiative and competition"²³

It is also troubling that such companies are set up without any impact analysis, non-transparently, and by eluding the legislation on corporate governance. The City Hall of Bucharest, for example, has recently set up over 20 state-owned companies²⁴, and there are concerns about an attempt to avoid the legislation on public procurements.

If there is proof that the incorporation of these companies is useful, there is no reason

23. Article 13 of the Romanian Constitution

24. The capital of the 20 new companies set up by the City Hall of Bucharest was increased last Thursday from 14.2 million lei to 420 million lei - the money coming from the budget of the City Hall, Hotnews http://www.hotnews.ro/stiri-administratie_locala-22026736-capitalul-celor-20-firme-proaspat-infiintate-primaria-capitalei-fost-majorat-joi-14-2-milioane-lei-420-milioane-lei-banii-urmand-vina-din-bugetul-primariei-capitalei.htm
The exceptions provided under Art. 31 of Law 98/2016 or under Art. 47 of Law 99/2016

to except them from the rules of corporate governance applicable to all state-owned companies - competitive and transparent selection of management, transparency of duties by the Letter of expectations, transparency of budgets, performance criteria and monitoring by the City Hall with a possibility to run independent verifications by the public, with full publication of all relevant information concerning their operation.

In this context, a clarification is required concerning the quality of contracting authority/entity of these companies (whether they are subject to the law on public procurements or not), especially since such companies may be awarded direct contracts by the municipalities having incorporated them²⁵, according to the so-called "in-house" rule.²⁶ The National Agency for Public Procurement is asked to clarify these criteria through an Instruction, in view of the jurisprudence of the Court of Justice of the European Union.

In comparison to national state-owned companies, local state-owned companies are in a critical situation. Their budget execution is often non-transparent and there is high incidence of politicisation, nepotism, in particular in companies under the direct subordination of the mayor or the president of the county council. The experts interviewed consider that interest groups at local level are much more visible, especially among politicians.

1.3.4. The need for a clear mechanism to assign responsibilities and monitoring tasks

The Ministry of Public Finance and public control authorities share this responsibility, but monitoring and evaluation of the performance is often done formally, inconsistency and without feedback.

"The Ministry receives the reports sent by companies to the MPF according to G.E.O. 109/2011. I think every now and then he analyses them, when he has to draft reports for international bodies. When monitoring is announced. But nothing is done about prevention and they don't say "look, in my opinion, there's a problem there, let's see how we can solve it together". There is no such thing."
(former secretary of state)

Reports by state-owned companies in Romania should be more frequent and more flexible. Adapting monitoring and evaluation to the evolution of the company and of the activity context, as well as the involvement of more stakeholders significantly reduce state capture possibilities.

Instability applied additional pressure on continuity and consolidation of institutional practices. During the reference period of this study frequent changes occurred at the level of political management (which generated incertitude and institutional bottlenecks) at the level of the institutional architecture of the public control authority and at the level of the company management. This inconsistency hindered the development of own monitoring and evaluation mechanism at the level of the public control authority.

25. About the "in-house" rule, Gelu Cazan, 1 November 2016, Public Procurement Magazine, AEXA

26. <http://www.avocat-achizitii.com/2016/11/despre-regula-house>

"Can we find a way to make the system more resilient to political pressure generated by the changes in the government? The companies from the ministries attract attention. If the Ministry sees himself or herself as some sort of company manager, they're no longer a policy maker for the country, but a super-director of the holding of these companies. So, instead of being concerned with the country, they are concerned with these companies" **(high-ranking civil servant)**

"What is a state-secretary doing in the board of a company? Part of the reason is the fact that their salaries are so low. (...) Usually they come from larger ministries - from Transport, Energy or Finance. There's a lot of work in these ministries, they don't need to get a second job. And, of course, you must dismiss others to make room for them. And when a government makes changes, there's always something to be changed in these boards." **(high-ranking civil servant)**

1.3.5. Financial sustainability of state-owned companies

Most state-owned companies in Romania are operating in increased uncertainty with regard to their future - between insolvency and restructuring. The financial situation of several state-owned companies is extremely sensitive, bringing a decrease in their intrinsic value and their production or profit capacity, while the perspectives of investments from the state budget are limited, and the privatisation process has made no progress for any of the companies included in the study.

On the other hand, the financial perspective and the perspective of investments for the most profitable state-owned companies was drastically reduced in 2017, by legislative measures and decisions of the government.

A first step was taken at the beginning of the year, when, through a "Memorandum", the Government imposed the "allocation of at least 90% of the net profit achieved in 2016."²⁷ Not even three months later, after finding that "the reserves established as a self-financing source from the undistributed profit for compulsory destinations are not used by companies where the state holds a majority stake, and by autonomous administrations. The surplus is reflected in their liquid assets". The Romanian government amended Ordinance 64/2001 on the distribution of profit in state-owned companies.²⁸ Through this amendment, the representatives of the State in the AGA could be mandated to request distribution to the state budget of the financial reserves of these companies, which had been set-up in the previous years.

Consequently, after the payment to the state of a minimum of 90% of the net profit for 2016 (and not a minimum of 50% as provided by the law) in September 2017 several state-

27. The legislation in force - Ordinance 64/2011 - only refers to a "minimum of 50%".

28. Therefore, G.E.O. 29/2017, the Government included a provision to allow redistribution to the state of these financial reserves of the companies in question, which had been established in the previous years as a self-financing source.

owned companies, in particular in the energy sector - *Romgaz*²⁹, *Conpet*, *Hidroelectrica*³⁰, *Transelectrica* and *Transgaz* - were informed by the Ministry of Economy about the urgent need to convene AGAs to approve the distribution to the state budget, in advance, as dividends, of undistributed profits from previous years, set up as self-financing sources.

“Everything you’re heard lately [editor’s note: about the Government’s decision to take the profit of the companies] was all done on the spur of the moment, they used those few sources where they could get money from - they took a part of the profit of the companies that are still making some money and they put all in the bag. Of course, in terms of calculating the motivation for performance in a company, the right things to do would be to allow the company to manage both its losses as well as its profits, that would be the ideal case.” **(former BA member)**

In addition, contextual factors such as the lack of infrastructure, outdated production equipment, poor qualification of human resources all limit the competitive potential of state-owned companies.

Risk management in state-owned companies in Romania is deficient or non-existent. In this context, politicisation and uncertainty puts additional pressure on the economic and financial decision which state-owned companies must undertake, thus impacting even further the potential to use state budget financing.

1.3.6. The minority shareholder – a “change agent”

The minority shareholder is seen by the interviewed experts as “change agent”, a “pressure factor” in the sense of observing the requirements of corporate governance.

“The existence of minority shareholders as a solution is superior to situations when the state holds 100% of the shares. The problem is how we can attract minority shareholders can be attracted, not because it’s not useful, but because it is useful and it is directly interested, it will generate a lot of noise, which creates pressure and is helpful. The problem is how you attract it. I’m thinking of Tarom and how long they’ve been talking about its privatisation...” **(former BA member)**

“As change agent in state-owned companies, I find that [the minority shareholder] works, it creates pressure. There can be situations in which, if the market is not well regulated, there can be abuses. But, all in all, companies are forced to be more professional, and less concerned with getting profit.” **(expert, high-ranking civil servant)**

In the end, it would be useful to involve the civil society to participate in the process of monitoring state-owned companies (at least from a procedural perspective), with the advantage of having a larger number of experts contributing, not just the staff of the specialised public units.

29. Another attack on the accounts of state-owned companies. The government is asking them to pay additional dividends of over 2 billion lei to the budget, Profit.ro, 9 September 2017 <https://www.profit.ro/stiri/politic/un-nou-asalt-asupra-conturilor-companiilor-de-stat-guvernul-le-cere-sa-verse-la-buget-dividende-suplimentare-de-pest-2-miliarde-lei-17198747>

30. Hidroelectrica was the first state-owned company to implement the order of the Government to transfer money to the state budget for the payment of pensions and salaries: It already approved dividends of 655 million lei, Hotnews, 13 September 2017, <http://economie.hotnews.ro/stiri-energie-22001019-hidroelectrica-este-prima-companie-stat-care-executat-ordinul-guvernului-vira-bani-buget-pentru-plata-pensiilor-salariilor-aprobat-deja-dividende-655-milioane-lei.htm>

1.3.7. Combating state capture networks: success stories and limitations of the criminal approach; the need for prevention

Due to institutional and decision-making instability, the consolidation of interest groups exceeded that of the administration and monitoring procedures of state-owned companies. In the fight against corruption, state-capture situations were identified. However, there were not preventive measures.

High-profile cases investigated by the National Anticorruption Directorate or DIICOT - Poșta Română (insurance policies and IT procurements, *Romsilva* (procurement of a tank as “forestry machinery”, procurement of unnecessary products, overvaluations and illegal retrocessions), the “smart guys” in the energy sector etc. - brought attention to the size of corruption, theft and losses incurred by state-owned companies.

Although essential to limiting the temptation of corruption, the mere actions of the National Anticorruption Directorate cannot solve the problem of state-owned companies. Beyond the spectacular nature of the cases and the size of the losses, criminal action is only part of the solution. The standard of proof of the criminal action - “beyond any reasonable doubt” - is, realistically speaking hard to achieve in many of these situations. On the other hand, the Constitutional Court limited the scope of application of the abuse of office, to include only those acts committed in non-observance of the primary legislation, which exempted from criminal liability a series of decisions made with infringement of government decisions, the job description or operating regulations.³¹

The success that the National Anticorruption Directorate has had - as one of the few institutions to work at high standards, being a model in the UE - can also create unrealistic expectations. The problems of the Romanian society, and in this case of state-owned companies, cannot be solved by the prosecutors. It’s not feasible, nor is it healthy to expect such a thing.

Many controversial decisions, causing important damages, inopportune procurements or investments, although obvious to the naked eye, they are not crimes and they can never be proven “beyond any reasonable doubt” before a judge.

That is why, it is necessary to have preventive mechanisms and intermediary measures, to apply other types of sanctions aside from criminal sanctions. An example worth considering is that of the sanctions applied by the Competition Council.

The National Anticorruption Strategy 2016-2020 is based on this paradigm shift, with an accent on prevention and education, aside from law enforcement actions, and any new corruption case is considered by the authors of the new strategy “a management failure”. The non-enforcement or the amputation of the legislation on corporate governance will lead to the spread of such “management failures”,³² and, implicitly to numerous corruption problems.

31. Following the decision of the CCR in the case concerning the procurement of a tank from scrap metal yard where there was a damage of 600,000 lei, the former director of *Romsilva* submitted an appeal against enforcement with regard to his final sentence from the High Court of Cassation and Justice. He won the case before the Bucharest Tribunal. The Bucharest Court of Appeal is awaiting a decision of the Panel on legal matters of the HCCJ in this case.

32. “It is not enough to fight corruption only through force, and through the extraordinary action of the National Anticorruption Directorate”, the paradigm shift “involves accountability on a managerial level”. Any new case investigated by the National Anticorruption Directorate or ANI, is, without a doubt, a management failure.” Raluca Pruna, 19 July 2016, <http://www.justitiecureata.ro/accent-pus-pe-prevenirea-coruptiei-ciolos-si-pruna-anunta-schimbarea-de-paradigma-in-strategia-anticoruptie>

2. STATE-OWNED COMPANIES: SECTORAL ANALYSIS AND CASE STUDIES

We selected 15 state-owned companies for a detailed analysis in the form of case studies and the identification of “objective” indicators to measure the progress of good governance or corruption over time and, as far as possible, relative to the other countries in the project (Bulgaria, Czech Republic, Italy). For these companies, we set up a limited number of indicators that can capture the impact of changes in the corporate governance framework on the performance of the companies concerned or that can make relevant comparisons between countries. For the sectoral analysis, we mainly used interviews with research experts.

2.1. SECTORAL ANALYSIS: TRANSPORT, ENERGY, COMMUNICATIONS AND PUBLIC UTILITIES

In the field of transport, with a number of large companies remaining subordinated to the state, the experts interviewed for this study indicate that these operate several types of interest groups. Situations like *TAROM* are highlighted, where low-cost private companies active on the Romanian market have employed former Tarom executives with relationships and influence, and these companies are now competitors. There are interest groups favouring port operators for various services (e.g.: piloting and towing, as revealed by an investigation conducted by the Competition Council).

One of the main challenges for the public control authorities in transport is to prioritize the development of certain investment objectives over others.

Until now, given the heterogeneity of the sub-sectors- road, air, rail and maritime- most of the time, political or personal affiliation relations have been the main anchor for the state investment decisions. The political alternation has made them change before any visible progress could be registered in any of the temporary “favoured” areas.

In 2016, the long-awaited General Transport Master Plan (GTMP) was finalized, but these issues of prioritization and implicit selection of public investment remain staggering given the nature of the zero-sum game between sectoral subdomains.

According to the GTMP, major investments in road infrastructure are planned in the coming years, but they are minimal in rail. This will require close monitoring of the work of the National Road Infrastructure Management Company (*CNAIR*, formerly *CNADNR*), taking into account past capture issues, as well as an inventory of *CFR* performance objectives.

Examples of state-owned transport companies whose activity was not deeply disturbed by clientelism and capture are, according to experts, companies such as *CNAB*- National Company Airports Bucharest- and *CERONAV*- Romanian Maritime Training Centre. The worst examples are companies like *CNAIR*, *TAROM*, *CFR Călători* or *CFR Infrastructura*.

In the energy sector, institutional experts have highlighted the existence of interest groups that encourage state capture in the extractive industry as well as in hydro-energetic facilities.

Concerning the mining industry, alarm signals are drawn to *Hunedoara Power Complex* and *Oltenia Power Complex*, where there are suspicions of significant political interference from local political leaders, as well as some private sector interests in relation to the public control authorities. At the energy sector level, there is also a prominent capture background from interest groups with private sector interference, such as the famous “Smart Guys Case” (see details below).

On the other hand, the energy sector benefits as a whole from the advantage of having several state-listed companies, which constrains the activity of the respective companies’ management and strengthens the quality of corporate governance. In addition, some sectoral reforms (Energy Law, market liberalization, the disappearance of controversial people with strong ties with state-owned electricity and gas companies) led to a better functioning of state-owned companies in the sector between 2012-2016.

The best examples of state-owned energy companies whose activity has not been deeply disturbed by clientelism and capture are, according to experts, companies such as *Transgaz*, *Romgaz*, *Hidroelectrica* or *Electrica*. *Hidroelectrica* is also mentioned as a negative example because of the past scandals, but the preparation process for its privatization has improved the corporate governance quality of this company.

Examples of companies perceived as clientelism and state capture means are: *Hidroserv*, *Oltenia Power Complex*, *Oil Terminal*, *ANAR* or *Conversmin*. In addition, a sore point for the energy sector is represented by the multitude of subsidiaries, branches and companies that are still not transparent, which operate beyond the central public authorities monitoring capacities.

The best examples of state-owned communications companies whose activity has not been deeply disturbed by clientelism and capture are, according to experts, companies such as *ICI* - National Institute for Research and Development in Informatics, *Telekom* or *OTE*.

A recurring example of a state-owned company affected by clientelism and discretionary practices is *Poșta Română*.

Regarding the **public utilities companies** in Romania, a great challenge is the implementation of the legislative framework at the level of the numerous companies under the local public administration. The plurality and granularity of this category of state-owned companies makes the monitoring activity at central government level extremely difficult.

Apavital, the water company under the Iasi City Hall, was included in this study. According to the latest legislative developments, which attempts to introduce dozens of exceptions from the application of GEO 109/2011, this company and others may not be subject to the legal provisions on corporate governance. Unlike many other local government

companies, *Apavital* is a large company whose activities should be carried out and monitored according to the requirements of corporate governance.

2.2. INDICATORS FOR MEASURING THE IMPACT OF CORPORATE GOVERNANCE ON PERFORMANCE

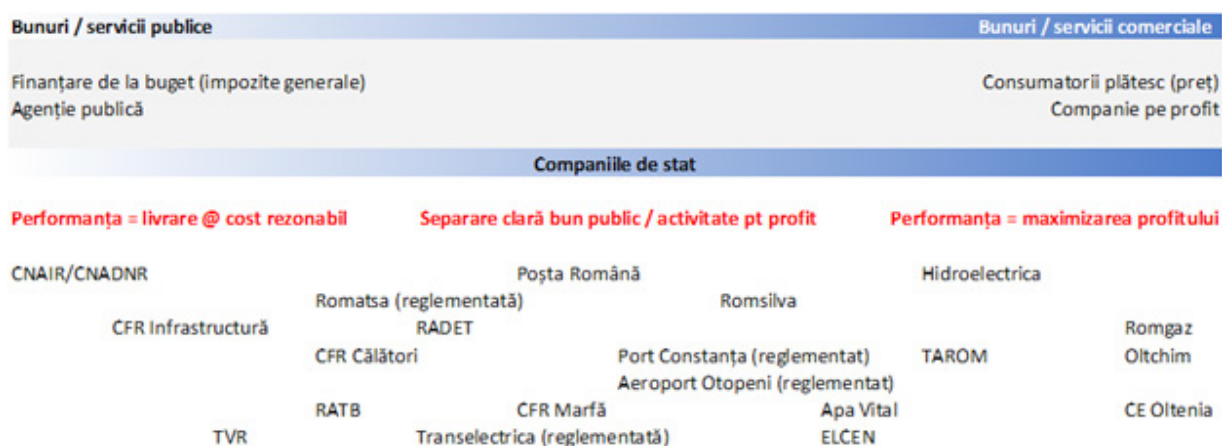
“Performance” is defined differently from company to company. Thus, state-owned companies are on a *continuum* between two extremes: similar to public agencies (financed from the budget to provide a public service) and profit-oriented companies (financed directly by consumers by paying a price). In the first case, the performance is measured in the form of delivery of the public good/public service at the lowest possible cost for a given quality (for example, the construction of a motorway at a given standard with the lowest cost per km). In the second, performance means maximizing profits.

Most state-owned companies are in the middle, delivering both public and commercial services. For example, *CFR Călători* offers a public service (safe and less polluting) but it also collects a price from consumers. A forest fund manager such as *Romsilva* tries to maximize profits from forestry exploitation but it also has the mission of sustainable management of the publicly owned forest fund. *Transelectrica*, although profit-oriented and collecting its revenues from electricity transmission charges, is a fully regulated company, being obliged to ensure the secure supply of electricity without interruption in the national energy system and to make investments to maintain the quality of this service in a sustainable way. *Poșta Română* offers courier and postal services comparable to its private competitors, but it also offers public services such as pensions delivery.

State-owned companies exclusively profit-oriented such as *Oltchim*, *Romgaz*, *CE Oltenia*, etc. do not differ in any way from their possible private competitors - in this case, it is legitimate to wonder what is the relevance of the state property.

In essence, the table below illustrates the link between the corporate governance framework of state-owned companies and their mission, respectively their performance. Companies that are “in the middle” between the two extremes must make a clear separation between the public service (service of general economic interest) and the profit-making activities. For this public service, the state must ensure adequate funding through transparent budget transfers, which also provides for parliamentary scrutiny of the budget allocations at the same time with the approval of the general budget. A clear separation between the state-financed public service and the commercial activity allows to define both meanings for performance for a state-owned company with mixed objectives: delivering the public service financed from the budget at a minimum cost for a given quality, and maximizing profits for the commercial activity.³³

33. For example, for years, the low profits of a company such as *Hidroelectrica* have been publicly justified by the fact that *Hidroelectrica* must also provide services that do not seek profit and generate costs that reduce the profitability of the company.



Note: The study did not analyse Oltchim, CFR Infrastructura, Romatsa, CFR Marfă, TVR, these companies are included in the table to better illustrate the positioning of the companies analysed in this continuum.

The indicators we propose are selected to illustrate the main risk areas for each company/ sector (over-valued public procurement, under-valued asset sales to partners with privileged relationships, management “clientelization” or politicization). The indicators used are based on each company’s balance sheet data, but also on more relevant “proxies” in some given situations, such as the profitability of “privileged partners” (a good indicator of corruption or clientelism).

We have thus two types of indicators:

- general, for all state-owned companies:

Applying the OECD governance standards for state-owned companies, defining company objectives, changes at the top management level in the company depending on business cycles.

For all types of state-owned companies, there is a risk of being “clientele” or “populated” with politically appointed people, especially in well-paid top positions. The easiest way is to follow the correlation between top-level appointments and electoral cycles or political changes at the level of the public control authorities- the *Rotation Index*.

Percentage of competitive purchases from the total of purchases.

Indicators on the concentration of suppliers or customers can be calculated, which may suggest a preferential relationship with some partners. Similarly, there may be purchases of unnecessary services and goods (especially legal services, consultancy, etc., and if they are exaggerated than such cases may suggest contracts awarded preferentially).

- specific per sector or company, as follows:

Profitability indicators make sense for profit-oriented companies or in the cases in which the profit-oriented activity can easily be separated from the public service. For such companies, the risks are mainly related to over-valued public purchases or under-valued sales of goods and services, which will be immediately reflected in the profitability indicators. As secondary indicators, benchmarking can be done for profitable companies operating in competitive sectors versus their private competitors, such as: comparison of the selling prices of state-owned companies (for preferential partners) with the market prices. "Proxy" indicators can be identified, for example, the profitability of the state-owned partner companies versus the profitability of companies in the same field that do not have privileged relations with the state.

For companies providing mainly budget-financed public services, in monopoly areas, mainly the unit cost indicators (cost/km, cost/product) make sense. For such companies, the major risk is overpriced procurement, and this can be determined by comparing the unit purchasing price for the same good in different countries (e.g.: km of motorway, construction, maintenance).

The evolution of indicators is then correlated with the evolution of the overall corporate governance framework. We use a colour rating system to illustrate the evolution of the corporate governance framework in general and for each of our companies and we show that there is a clear correlation between performance and good governance.

2.3. STATE-OWNED COMPANY POLITICIZATION - *ROTATION INDEX*

The *Rotation Index* is an indicator that correlated the changes in top management of state-owned companies to the political changes in the public control authorities, changes stemming from parliamentary elections and the appointment of a new government.

Data from the past 9 years have been correlated- starting with the 2008 general elections, the 2016 parliamentary elections, including the changes that took place in 2017. Correlations and analyses of all governments from 2008 to 2017, as outlined in the table, have been highlighted.

Politicization at the level of the analysed state-owned companies

Company	Average term in office duration of the GD	Record of political changes
TAROM	1 year	YES
Constanța Port	1.5 years	YES
CFR Călători	1 year	YES

National Airports Company Bucharest	1 year	YES
RATB	Under 1 year	YES
Poșta Română	1 years	YES
ELCEN	insolvency	partially
Hidroelectrică	insolvency	NO
Romgaz	4 years	NO
Transelectrica	4 years	NO
CE Oltenia	3-4 years	YES
Romsilva	1 year and 9 months	YES
CNADNR	Under 1 year	YES
RADET	insolvency	YES

Source: Authors' analysis based on public information on the appointment and revocation of executives of the state-owned companies analysed.

Some of the companies have entered insolvency in recent years and have special administrators. Some companies have been more strictly supervised from outside (e.g.: IMF) and the initial selection was made by applying to a larger extent GEO 109/2011 with a real competitive selection based on competence criteria. In other companies (e.g.: CE Oltenia), the selection was formally achieved by applying GEO 109/2011, but the results of the selection were visibly politically influenced. In other situations, especially in transport, the application of GEO 109/2011 was flawed even under IMF monitoring.

The data analysis indicates that the majority of companies surveyed had an average management duration of one year to a year and a half, the political changes triggering changes in the management of state-owned companies.

For example, the *National Company Airports Bucharest* has had at least seven management changes at the highest level for the past eight years, most of which have been operated within two to six months after the arrival of a new Minister for Transport. The fastest changes made to this company came after the USL Government came to power in 2014 and following the December 2016 elections. *CFR Călători* has often been targeted by changes in the top management and board of directors shortly after political changes/elections. Thus, during the last 9 years, the Ministry of Transport had 12 ministers and the management of *CFR Călători* was changed seven times, with an average duration of the term of office of a general director of approximately one year. In the last 10 years, TAROM had seven general directors, and the fastest and most obvious changes in company leadership occurred in two cases: Ruxandra Brutaru, appointed general director by Radu Berceanu in 2009, and Eugen Davidoiu, appointed in 2017 during the term in office of Răzvan Alexandru Cuc.

The most stable companies were the energy companies, *Romgaz* and *Transelectrica*.

2.4. CORPORATE GOVERNANCE AND PERFORMANCE OF STATE-OWNED COMPANIES. CASE STUDIES

To assess the impact that the overall corporate governance framework had on company performance by reducing corruption and mismanagement, we have calculated a series of indicators for five of the selected companies

Corporate governance characteristics at the level of the companies analysed

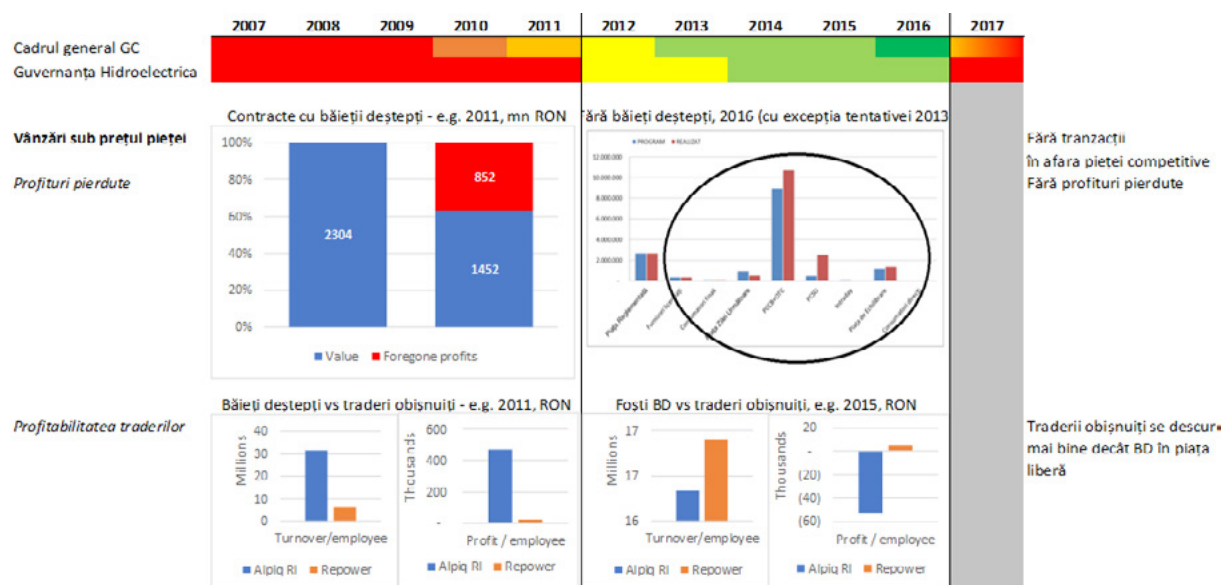
Company	EcoFin Reporting	Information Accessibility	NonFin Reporting	Statement of ownership by the State	Politicization	State control	Relationship with shareholders
ELCEN	Limited	Limited or no access	Limited or inexistent	Little justification	Very high	Low or none	Weak
Hidroelectrica	Very good	Good or very good	Very good	Good justification	Very high	Low	Weak
Romgaz	Good or very good	Good or very good	Limited or inexistent	Good justification	Average	Good or very good	Good or very good
Transelectrica	Good or very good	Good or very good	Limited or inexistent	Justified	High	Average	Good
CE Oltenia	Good	Good	Inexistent	Unjustified	Very high	Low	Average
Romsilva	Limited or inexistent	Limited or inexistent	Inexistent	Fully justified	Very high	Low or none	n.a.
TAROM	Limited	Limited	Limited or inexistent	Little justification	High	Low	Weak
Port of Constanta	Limited	Limited	Limited or inexistent	Fully justified	Very high	Low	Weak
CFR	Good	Good	Limited	Fully justified	High	Good	Average
Airports	Average	Average	Average	Fully justified	High	Average	Good
Poșta Română	Average	Average	Limited	Little justification	Very high	Average	Weak

Source: the expert questionnaire applied in April 2017 by the authors, the average values of the Likert scale answers

2.4.1. Hidroelectrica

The electricity producer has been selling energy at undervalued prices for the so-called “Smart Guys” for years. There have been numerous overpriced procurement scandals for maintenance and rehabilitation works with *Hidroserv*, company which is strongly supported locally. Some of these issues have been solved via the energy reforms and the “cleaning up” of controversial contracts during the insolvency procedure. To illustrate this, we have calculated some of the indicators plotted below.

Undervalued sales - *Hidroelectrica*:

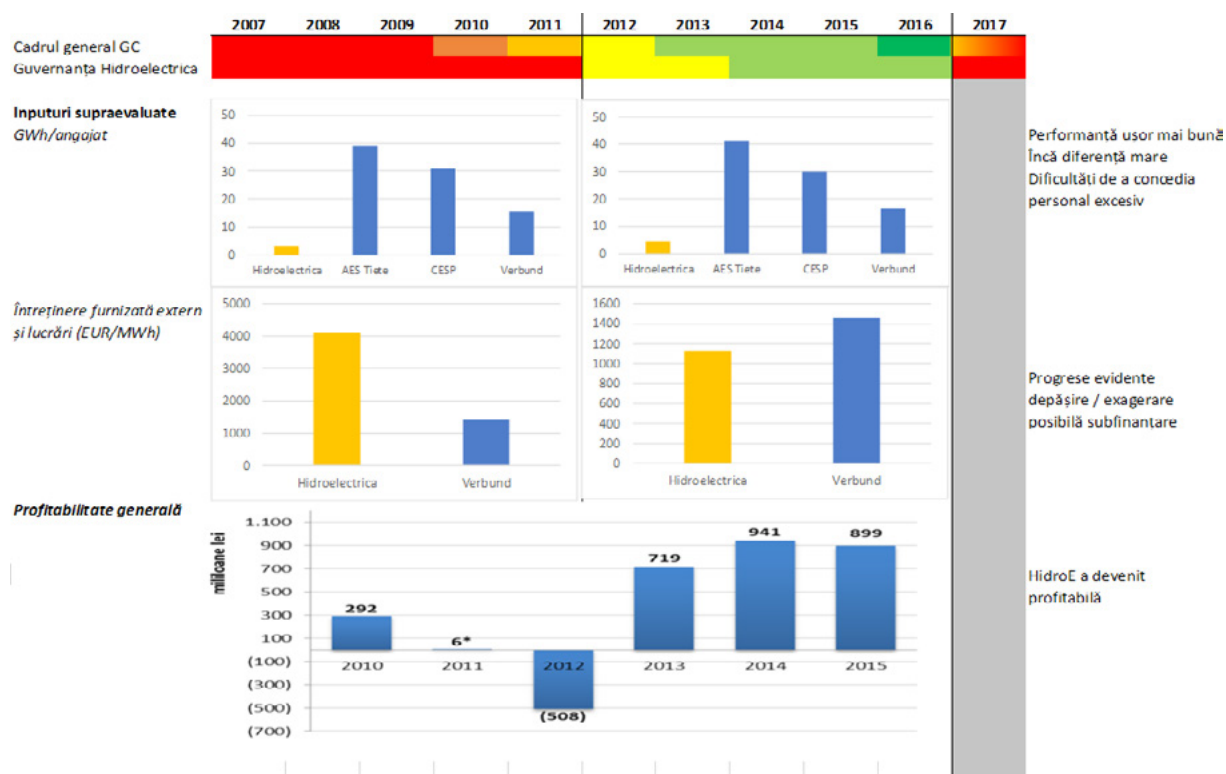


When comparing the prices at which it could sell energy on the OPCOM free market, it turns out that by selling energy to “preferential customers” *Hidroelectrica* lost significant potential profits (e.g.: in 2011- 852 million lei).

Starting 2012, *Hidroelectrica* sells exclusively on competitive markets, that is, there is no possibility of such potential profit loss, it sells automatically, transparently, to whoever offers the best price.

This can also be seen by analysing the profitability of former partners. In 2011, one of these “smart guys” had employee earnings about 4 times higher than a competitor trader operating exclusively on the free market without preferential relations with the state. After 2012, the traders with such preferential relationships have lost ground and are doing much worse than regular traders.

Overvalued procurement - *Hidroelectrica*:



A similar analysis can be made for inputs, employees, and maintenance and works. To determine the level of over-valuation, we set up benchmarking indicators by comparing *Hidroelectrica's* performance with the performance of similar foreign companies (hydro producers).

Thus, we identify the excessive number of employees based on *output per employee*, which suggests clientelism at local level: *Hidroelectrica's* territorial branches employ an excessive number of people who are not dismissed, including because they represent a strong local electoral support. Even following the insolvency cuts, redundant staff restructuring was almost impossible.

Regarding the purchase of maintenance and rehabilitation works, usually carried out with *Hidroserv*, a *Hidroelectrica* subsidiary strongly anchored in the local area, the costs of such works were much exaggerated: the cost/MWh produced was 3 times higher than the cost of the counterpart Austrian company Verbund.

After 2012, following insolvency, this problem was solved, with the costs being significantly reduced. However, there are signs that some works have been excessively cut and that the consequences could be seen in the years to come.

Combining both types of embezzlement present in *Hidroelectrica*, we identify the impact on the company's overall profitability: *Hidroelectrica* simply suffered losses in the years of bad governance and rising profits in the years when the classic embezzlement schemes were abandoned.

2.4.2. CNADNR

The Romanian National Company of Motorways and National Roads - the former National Roads Administration - is an entity in charge of building and maintaining the national road infrastructure network.

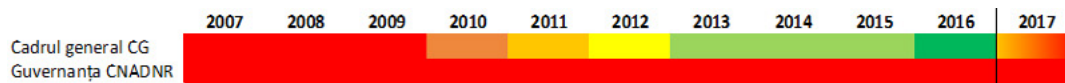
The performance of such non-profitable entity is measured based on how it minimises costs for the budget for a given quality of the road infrastructure. Consequently, we monitor public procurement indicators. Here we can find a correlation between corporate governance and performance quality.

Although in Romania, the corporate governance framework improved substantially in 2012-2016, in the case of CNADNR, the legislation was simply never applied (interim managers were appointed for an average period of 1 year, with corruption scandals - please see the Rotation Index).

Indeed, some public procurement practices changed, in particular because all major constructions - new motorways - were financed from EU funds. We present governance problems within CNADNR by analysing the profitability of "preferential partners" (Romanian companies) as compared to the profitability of European companies selected in transparent tender procedures.

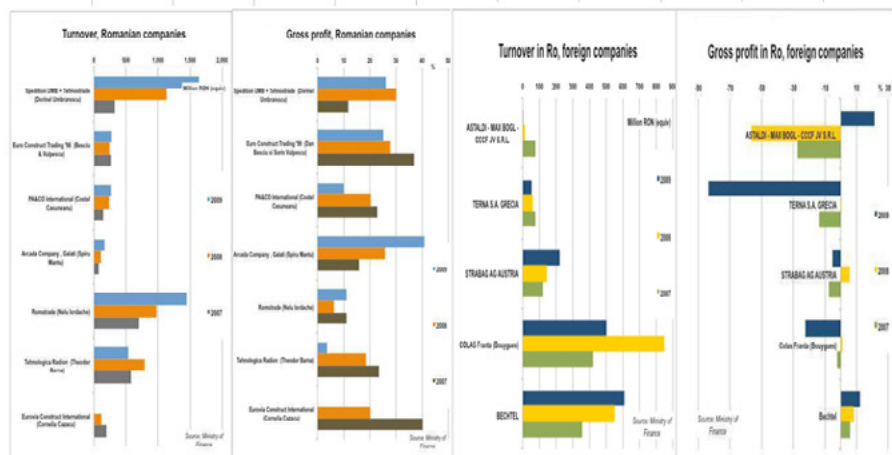
In 2011, "preferential partners" - the Romanian companies, had profits of over 40%, whereas foreign companies had normal margins of 3 to 5%. An improvement is identifiable in a high-profile National Anticorruption Directorate investigation - the Nelu Iordache case. By analysing the profitability of its company, Romstade, we notice a spectacular increase during a preferential contract (the Transalpina case, as shown in the case study) and subsequent losses, unlike the profitability profile of a "normal" company, selected in an international tender procedure, for "cleaner" projects, with EU funds. Nelu Iordache was sentenced in a different case than Transalpina for fraud involving EU funds.

Overvalued procurement - consultancy - CNADNR

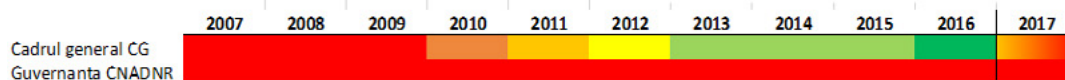


*Achiziții
Profit parteneri*

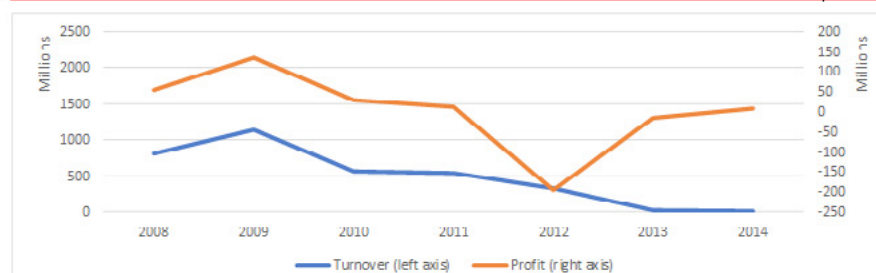
*Co Rom vs străine
e.g. 2011*



Co străine mai puțin profitabile (licitații)

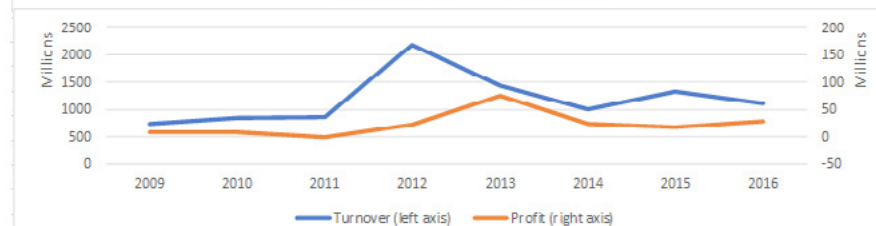


Romstrade



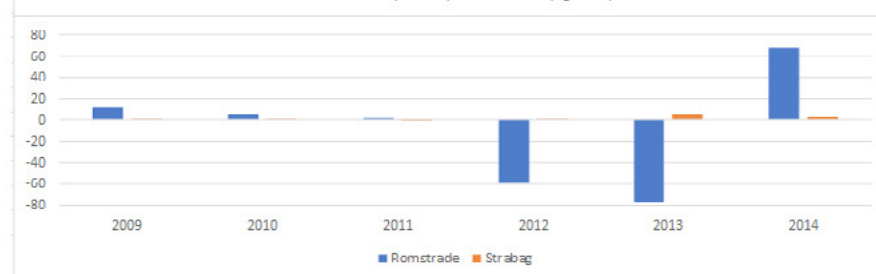
Vârf excepțional: Transalpina din 2015 insolvență

Strabag



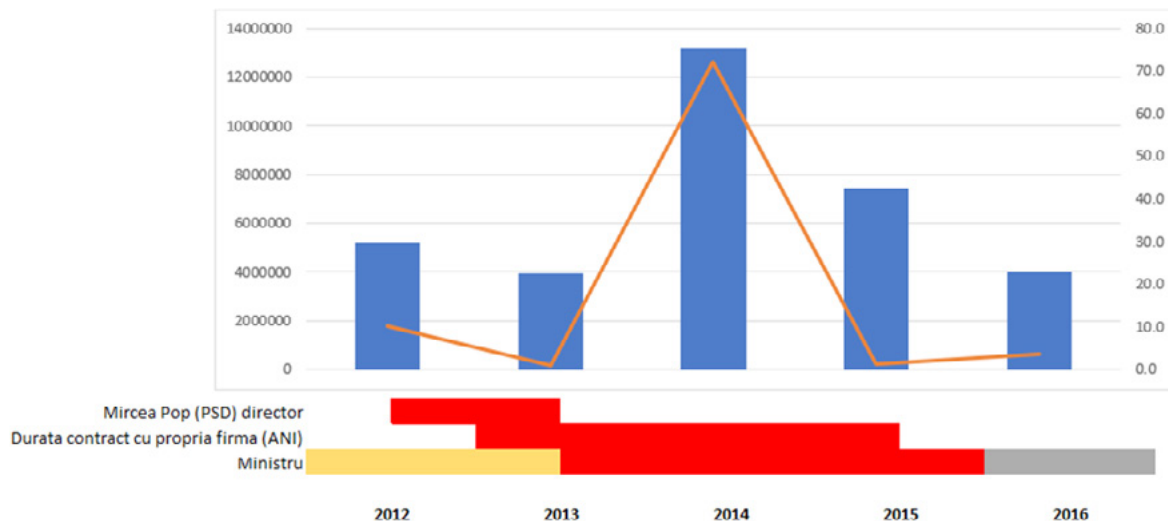
Proiecte cu fonduri UE încep în 2012

Romstrade vs Strabag profitabilitate



Strabag rate normale de profitabilitate

An interesting indicator to illustrate the level of clientelism is the case of the general director dismissed from CNADNR due to a conflict of interests: he signed a contract between CNADNR and his own company for consultancy services. His company made spectacular profit while it had a contract with CNADNR, and later returned to lower revenue after the expiry of the contract.



2.4.3. ELCEN-RADET

Not all major governance problems indicate corruption and public money fraud by private individuals or political party networks. The ELCEN-RADET case in Bucharest (just like a good part of the heating sector in Romania) proves that an important area of clientelism is irresponsible populism involving public money - for instance, through low energy prices simply to gain votes or political popularity. The problem is that the price of this popularity is eventually paid by the citizens, but it is hidden or postponed for future generations.

ELCEN produces 40% of the thermal energy in Romania and 90% of the thermal energy in Bucharest, while RADET covers 75% of the thermal energy needs in the capital city (95% of its customers are household consumers). ELCEN and RADET are real black holes: both are inefficient and have massive energy losses during the production, transport and distribution chain, which is reflected in the real cost of thermal energy in Bucharest. In order to hide the actual cost, the City Hall requests that RADET issue invoices to consumers amounting to 50% of the cost, promising that the other 50% will be covered by a subsidy from the budget of the City Hall, yet it fails to do so, which increases arrears in the system and increases the burden of future generation for immediate political gain. The public is relatively satisfied - the cost of a GCal is less than in the other cities. But behind the lack of transparency concerning the actual costs, there is always a possibility for some of these costs to be overvalued through bad procurement at ELCEN or RADET, which would be difficult to spot by the citizens, since the actual price is hidden. This Ponzi scheme would not be possible if RADET would observe the corporate governance

criteria. In theory, RADET could impose full and immediate payment of outstanding payment from the City Hall, otherwise, it could receive the money straight from the Ministry of Public Finance to the City Hall from the broken-down shares of the income tax, according to Art. 3 Paragraph (5) of G.E.O. 69/2011. For this to take place, RADET should inform the Ministry of Administration, which should send centralised requests from all thermal energy providers to the MPF. But this is never the case - because the management is politicised and directly dependent on the City Hall - and, so, the debt piles up, reaching 3.6 billion lei at the end of 2016, almost equal to the entire budget of the Bucharest City Hall.

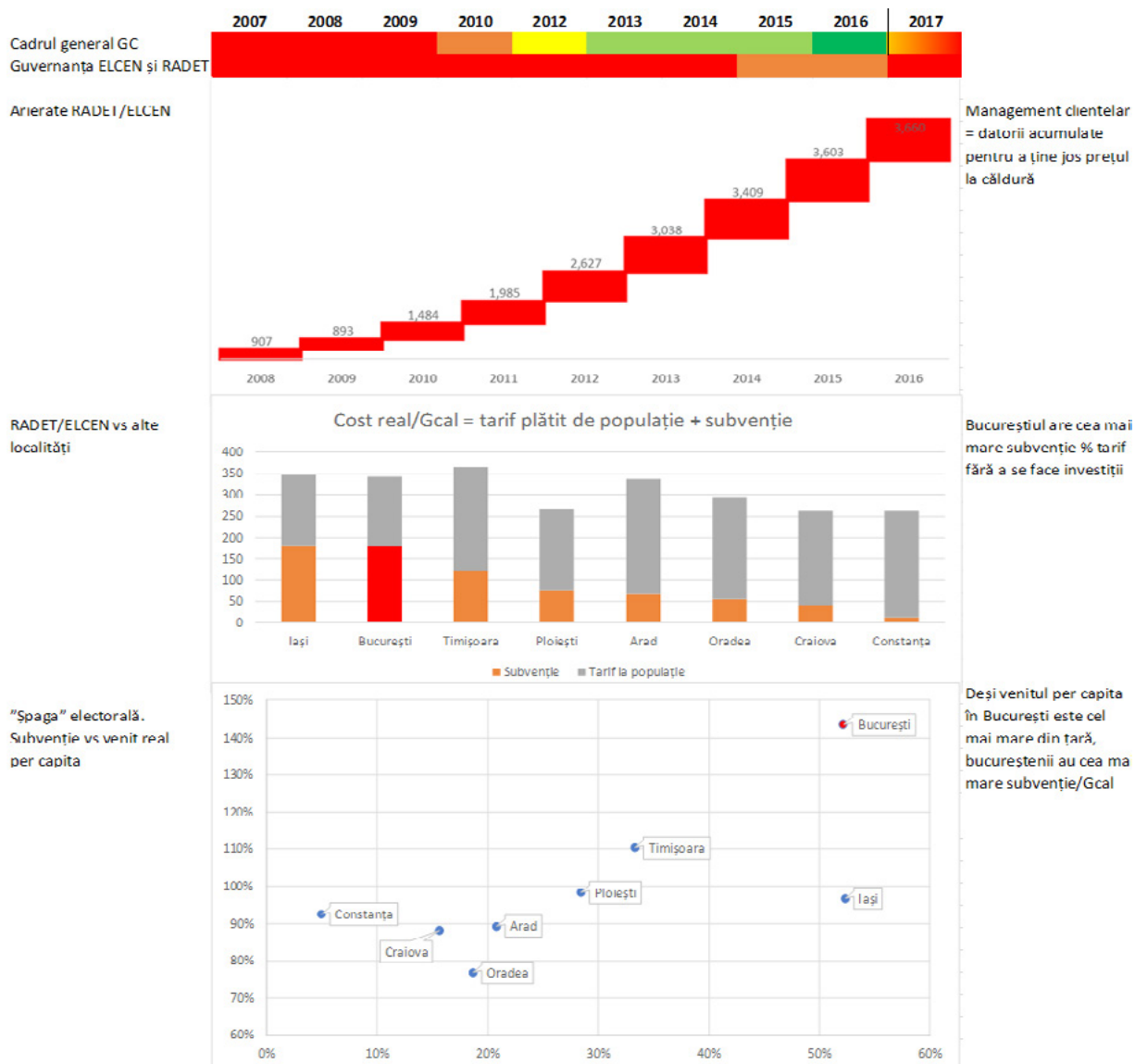
What should be noted is that, despite the fact that both the management of ELCEN and of RADET should have been selected based on G.E.O. 109/2011, but this was only partially applied. In August 2016, the management selected in line with G.E.O. 109/2011 at RADET was quickly dismissed by the new mayor, and replaced by individuals of doubtful competences, but closer to the mayor.³⁴

Moreover, the take-over of ELCEN by the Bucharest City Hall and the set-up of a new water heating company in Bucharest exempted from G.E.O. 109/2011, instead of clarifying the situation of the financial bottleneck in the system, is a guarantee that these bad practices will continue.

In comparison to other large cities, where there is still water heating, the subsidy/GCal in Bucharest is among the highest in the country. In Bucharest, where there are 560,000 connections, the cost per GCal should be more reduced than in cities like Iasi (37,000 connections), Constanta (78,000), Ploiesti (56,000), Timisoara (60,000) or Oradea (64,000). However, the cost is incomparable to Iasi, where, unlike Bucharest, major investment is carried out to modernise the system and extend connections, or to Timisoara, where such modernisation works were also carried out. Oradea is a city where the system was restructured and modernised and the cost per GCal is significantly lower than in Bucharest (295 lei as compared to 343 lei in 2016).

If we take into account the net salary revenue, we find that the citizens of Bucharest receive the most substantial subsidy - 52% of the price - although they get the highest salaries - 143% as compared to the national average. In these conditions, such generous support is, in fact, not so much a form of social support, but of electoral bribery. Moreover, since the City Hall of Bucharest is not even paying for the full subsidy, but it is generating chain arrears: RADET - ELCEN - Romgaz - all Romanians are actually subsidising the richest citizens, those living in Bucharest, since ELCEN and Romgaz are national companies.

34. http://adevarul.ro/news/politica/cum-impus-firea-nouaconducere-radet-unul-membrii-consiliul-administratie-e-specialistin-artapsihoterapiei-l_57a09f775ab6550cb86a928b/index.html



2.4.4. Romgaz

Romgaz is producing half of the Romanian natural gas. For many years, the price of natural gas in Romania was regulated to a lower level, mainly to benefit large industrial consumers (including *Interagro*). Between 2003-2013, the overall losses in the natural gas sector to support this complicated and unprofitable scheme were of 13.83 billion lei, which is more than 3 billion EUR.³⁵ At the time, the state could legally collect this entire amount as taxes from the two producers to finance a social aid scheme for all household consumers. Here we will only be analysing Romgaz and its losses, as well as the improvement of performance with the corporate governance reforms and the sectoral reforms.

35. <http://tefuralafactura.ro/cat-te-fura/gaze-pierderi-neliberalizare>

Romgaz incurred damages both due to non-transparent contracts with “preferential clients” (we described in the case studies the DIICOT cases involving illegal discounts given to Interagro), as well as due to global regulations for the entire natural gas sector to the benefit of the same company (which is the subject matter of a different case).

After 2011, G.E.O. 109/2011 was applied quite strictly in the case of Romgaz, being closely monitored by IMF, and in 2013, the company was listed on the Bucharest Stock Exchange and of the London Stock Exchange - which imposed corporate governance standards. *Romgaz* also has a minority shareholder - *Fondul Proprietatea* - which pushed for better administration of the company.

In 2017, interim managers were politically appointed, with short-term mandates³⁶ and the company was forced to pay dividends in advance of 750 million lei (525 million to the state budget).³⁷

In the natural gas sector, important structural reforms were carried out, including full liberalisation of the market (in 2014 for industrial consumers, and in 2017 for household consumers), which eliminated the possibility of “special regulations” to ensure “cheap gas” for privileged clients.

Before the Energy Law of 2012, large consumers had the possibility of returning to the regulated sector at any point, consequently, as indicated in the DIICOT investigation, *Interagro* bought natural gas at a regulated price, although in theory, they were on the free market. In theory, the only restriction for consumers on the free market would have been related to purchasing gas at a freely negotiated price while observing a certain national to import ratio, in order to preserve the same rations in the regulated sector (household consumers and SMEs). In practice, *Interagro* was buying internally produced gas at a regulated price both from *Romgaz* and from *Petrom* (which continued to sell this natural gas at this price to avoid conflicts with the state). Moreover, *Interagro* managed to obtain contracts from *Romgaz* only for internally produced gas, at a very low price, even when market regulations imposed purchasing natural gas for a mean value between the import price and the national price. According to DIICOT *Interagro* bought 5.6 bcm between 2005 and 2010 from *Romgaz*, therefore, we estimate that *Interagro* bought approximately 1 bcm per year from this company at internal production price. Discounts amounted to about 274 million lei between 2008 and 2010, according to the same investigation. based on an estimation in line with the volumes bought each year.

36. <http://romaniailibera.ro/economie/companii/noi-numiri-politice-la-romgaz-466401>

37. <http://economie.hotnews.ro/stiri-energie-21995674-fara-precedent-ministerul-energiei-vrea-forteze-romgaz-vireze-bugetul-statului-pest-500-milioane-lei-patru-luni-inainte-finalul-anului.htm>

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Cadrul general GC Guvernanta Romgaz											
Preț gaz intern lei/1000mc	432	454	426	420	464	477	548	688			
Preț import lei/1000mc	744	1079	964	1094	1324	1729	1504	1436			
Diferența	313	625	537	674	860						
Beneficiu estimat Interagro MRON	313	625	537	674	860						
Discount mediu	47	93	80	101	128						
TOTAL mil RON estimat	359	718	617	775	989						

Profituri pierdute 2010

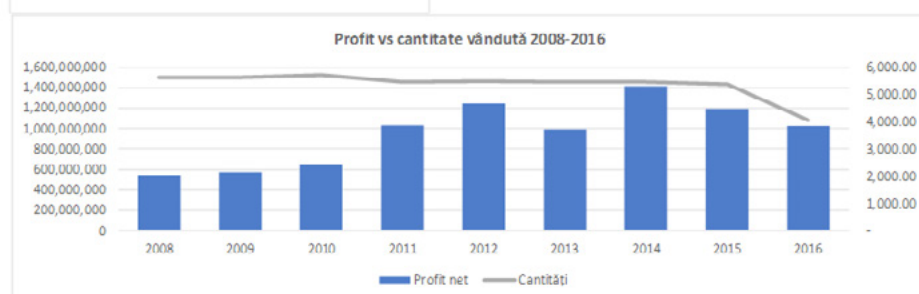


Interagro a beneficiat de reglementări care afectau întreaga piață.

Din 2012, piața s-a liberalizat gradual, iar Interagro a beneficiat din ce în ce mai puțin de contracte preferențiale, din cauza legii energiei, dosarelor și temerilor angajaților în sector de un nou dosar. Prețurile reglementate după 2012 au fost în primul rând în beneficiul consumatorilor casnici.

Din 2011-2012, profitabilitatea companiei a crescut odată cu terminarea efectelor OUG gaze ieftine 2009-2010 și cu liberalizarea. 2015-2016 profitabilitatea a scăzut din cauza scăderii cererii și a cantităților vândute și a prețului din piața liberă odată cu liberalizarea. În 2013 au crescut cheltuielile de exploatare

Profitabilitate generală



2.4.5. Romsilva

The National Forest Administration - *Romsilva* - is in charge of the sustainable and uniform administration of publicly owned forests, - 3,146 thousand ha, about 50% of the national forests. Romsilva's mission is not essentially of gaining profit, which increases the relevance of the indicators related to: the costs to achieve this mission, the quality and the justification of public procurement, the administration of their impressive assets and the integrity of the management.

The image and the activity of this company were affected by corruption scandals and strong politicisation. The managers appointed were members of the party subsidiaries most loyal to the appointing prime minister: *Arges, Dambovită, Timiș* (PSD, under Adrian Nastase and Victor Ponta) or *Suceava* (PDL, under Emil Boc/ Gheorghe Flutur). The periods marked by extremely politicised management greatly overlap the corruption scandals in which Romsilva was involved.

Between 2001 and 2003, the National Forest Administration was headed by Filip Georgescu, at the time head of PSD Arges, a deputy in the Romanian Parliament and director of *Romsilva*.

Between 2003 and 2004, Ion Dumitru was appointed director at *Romsilva* - who was close to prime minister Nastase, from PSD Dambovită, who later became a Senator. Ion Dumitru forced dozens of forest districts to contribute to the "*Quality Trophy*" together with six other state-owned companies (this was part of the criminal case concerning the illegal financing of Adrian Nastase's political campaign). Ion Dumitru was sentenced for purchasing a tank from a scrap metal yard as "forestry machinery" in 2009 in a rigged tender procedure with respect to which the National Anticorruption Directorate indicated damages of 10 million lei.³⁸

Valerian Solovastry, a local leader of PDL Suceava and a close friend of the influent Gheorghe Flutur headed *Romsilva* between 2009 and 2012. Solovastru was politically appointed and he submitted his resignation immediately after the dismissal of the Ungureanu government by a motion of no confidence.

Adam Craciunescu was appointed by Ministerial order in June 2012. He was a close friend to the PSD leader Ilie Sarbu. In 2013, during his mandate as *Romsilva* director, he became executive president of PSD Timis. In December 2014, after being placed under judicial control, he resigned from his position within PSD Timis, but he remained director of *Romsilva*. He was forced to resign in January 2016 by Cristiana Pasca-Palmer, the Ministry of Environment at the time, a year after he was sent to trial in a case concerning the retrocession of 43,000 ha of forests in Bacău, with damages of 1.4 billion lei (approximately 304 million EUR) involving two other party members.³⁹⁴⁰

After these political and judicial adventures, new management at *Romsilva* was selected in May 2016, after a selection process conducted based on G.E.O. 109/2016. There is a system of indicators for economic, technical and management performance, which are evaluated quarterly. As of 2015, the activity report of the board of administration has been published quarterly on the webpage of the institution, as well the Administration plan, the commercial strategy and the performance indicators for the director and the BA members.

All public tenders for wood were uploaded in the previous year to the website of the institution, with details about the qualitative and quantitative assessment of the wood volume, the parquet sketch and the GPS coordinates for each area where exploration is carried out.

38. <http://anticoruptie.hotnews.ro/ancheta-7734156-dosarul-romsilva-ion-dumitru.htm>

39. <http://www.pna.ro/comunicatxhtml?id=5377>

40. <http://www.pna.ro/comunicatxhtml?id=5815>

3. SPECIFIC STATE CAPTURE AND CLIENTELISM MECHANISMS

Specialised literature distinguishes between clientelism, patronage, corruption and state capture because, although these phenomena are subject to the same incidence, they work on different sectors. Overall, these phenomena represent informal practices of administration of public resources.

Public resources which can be subject to informal changes can be direct financial resources - payments in the case of “dedicated” contracts, or unprofitable contractual agreements, such as the provision of exaggerated penalties - or indirect resources - profits gained by a private company buying energy from the state at an undervalued price. Financial resources are most often used in clientelistic schemes, because they can travel from the political owners to private companies and back to the political owners, as bribery or as a means for electoral mobilisation.⁴¹

The state capture process is also aimed at some non-financial resources. Public positions are a key objective for the manipulation of resources and institutional processes, but also a way to reward individuals loyal to the political patronage.⁴² Public assets can also bring numerous private benefits by preferential use - undervalued lease of public facilities or land plots - or by transferring the right of usage in conditions that are unprofitable for the state. Another category of non-financial resources are decisions and regulations which can create advantages for political clientele and/ or disadvantages for their competitors.

Types of resources targeted by clientelistic networks

FINANCIAL RESOURCES	NON-FINANCIAL RESOURCES
<ul style="list-style-type: none">• Profits obtained straight from payments carried out by the state to legal entities or private individuals• Profits derived indirectly following undervalued sales by the state	<ul style="list-style-type: none">• Public assets (e.g.: land, production machinery)• Public positions• Regulations and decisions in favour of the clientele

Source: the authors

41. Gherghina, S., & Volintiru, C. (2017). A new model of clientelism: political parties, public resources, and private contributors. *European Political Science Review*, 9(1), 115-137.

42. Volintiru, C. (2015). The exploitative function of party patronage: does it serve the party's interest?. *East European Politics*, 31(1), 39-55.

3.1. CLIENTELISM

Clientelism is the selective distribution of benefits to individuals or clearly defined groups in exchange for political support⁴³. The preferential selection of the recipients, makes clientelistic distribution different from partisan distribution (when a party or a politician channels state resources through public policies to its political supporters), the latter being a characteristic of any representative political system.

The experts interviewed agree that political decision-makers still have great influence at the level of the management of state-owned companies and they warn that although there are specialists within these companies, there is no resistance to the frequent changes and clientelistic influences - on the contrary, these are tolerated, irrespective of government successions.

"I don't see the idea of a group of interests or of several groups of interests acting jointly. It's something smoother than that. There are some areas generating revenue, which, in time, attract those closer to the core of political power. Well, if we don't do something about the others, things won't be in order after these ones leave. So, when another party is elected, that party's friends show up. And this doesn't mean the others are eliminated from the equation. The source or the problem is somehow within the companies. **(expert, high-ranking governmental civil servant)**

3.2. TYPES OF STATE CAPTURE

State capture can be analysed from two perspectives. On the one hand, there is *exogenous capture* (from outside the state apparatus), under the form of private capture initiated by private agents. We're faced with this type of capture in cases such as that of the "the Smarty guys" in the energy sector. Most often it involves influence peddling around political decision-makers, in order to deviate the profit and the resources of state-owned companies to other economic agents. The World Bank defines this type of state capture as a sum of the efforts of a small number of firms or groups to shape the rules of the game to their advantage through illicit, non-transparent methods.

Anti-competitive understandings between companies providing pilotage and towage services in the *Port of Constanta* are an example of exogenous private state capture, identified during an investigation of the Competition Council carried out at the National Company *Administrația Porturilor Maritime Constanța*. The understandings between the three private operators ensuring pilotage for *CNAPM* (which even had a penalty clause of 5 million EUR for leaving the Cartel) resulted in tariffs 2 to 3 times higher than in other ports of the European Union. *CNAPM* also restricted competition through the application of restrictive conditions to issue the authorisation to operate in the port.⁴⁴

43. Hopkin, J. (2006). Conceptualizing political clientelism: Political exchange and democratic theory. In APSA annual meeting, Philadelphia (Vol. 31, pp. 46-18).

44. The companies in the investigation of the Competition Council were fined between 88,000 and 431,000 EUR, and *CNAPM* Constanta was fined EUR 2,650,000.

On the other hand, there's *endogenous capture* (from within the state apparatus), under the form of political capture initiated by decision-makers in high-ranking positions and by other elected representatives. Most often, it involves abuse of office, bribery and other corruption acts. This type of state capture is defined in the specialty literature in the context of the new European democracies, entailing "extraction of private benefits from the state to the occupants of public positions."⁴⁵

The typology of clientelistic network patronage

Source: the authors

Typology of capture mechanisms

Manipulation:

- of **procedures** (e.g.: performance indicators are sometimes meant to "find an excuse for inefficiency, not to measure performance" or they are used to "justify political resignations")
- of **needs** (e.g.) procurement outside the PAAP or unscheduled)
- of **assets** (e.g.: there is no clear record of the assets of state-owned companies)

Source: the authors

With regard to state capture mechanisms, there are several types of patterns, derived both from the type of targeted public resource and from the specific approach of the group of interests.

State capture can also occur through procedural options carried out by the control authority or by the state-owned company. One example to illustrate this is the fact that performance indicators are not clearly delimited and undertaken, precisely to facilitate political interference in appointments and dismissals.

There is also state capture through the manipulation of needs in state-owned companies. Most often, unscheduled, unjustified procurement is conducted, without tender procedures and sometimes at overvalued prices.

One example of state capture by manipulation of needs initiated from within the institution was the purchase by Romsilva of a tank from a scrap metal yard from Ukraine for the price of USD 294,330 - with a mark-up of 1,744% - whose customs value was of USD 6,250 and which was later transformed into "forestry machinery". The tank could never be used as forestry machinery. *Romsilva* also bought 20 tranquilliser weapons at an overvalued price (by 70 to 480%) for RON 1,673,700, in a rigged tender procedure, without any substantiation note

45. Grzymala-Busse, A. (2008). Beyond clientelism: Incumbent state capture and state formation. *Comparative Political Studies*, 41(4-5), 638-673.

or purchase requisition. These tranquilliser weapons were rejected by 5 forestry divisions, since they did not have any cynegetic duties.

Manipulation of needs was also a finding of a report filled by the Tax Administration⁴⁶ (ANAF), which showed that several state-owned companies, including *CET Govora* and *CNADNR* paid millions of euros for legal advice considered useless, since these companies had numerous in-house legal advisors. In 2011, according to the Tax Administration, *CET Govora* paid EUR 30,000 per month to two law firms, in 2013 it paid EUR 10,000 per month to one law firm, and between 2014 and 2015 it paid EUR 160,000 to another law firm for legal assistance and court representation.

The same report by the Tax Administration shows that in 2013 *CNADNR* paid over one million EUR, and in 2014 and 2015 over EUR 660,000 to a law firm close to the former Ministry of Transport and Senator, Dan Sova.

With respect to the payments made by *CET Govora* for external legal advice, the National Anticorruption Directorate indicted former Senator Dan Sova and the former director of *CET Govora* for the subscription contracts of 2011 and 2013 with a law firm, costing *CET Govora* EUR 10,000 per month.⁴⁷ In first instance, Dan Sova was sentenced to 3 years in prison for influence peddling, and the director of *CET Govora* to 3 years suspended sentence for abuse of office.⁴⁸

In the end, one of the most important resources of state-owned companies in Romania is the assets they control. From land, to machinery, state-owned companies often do not keep systematic records of their assets. Undervalued subletting often leads profits derived from public assets to private companies with political affiliations.

An example of state capture by use of the assets of state-owned companies is the case of the illegal forest retrocessions, in which former Romsilva director Adam Craciunescu was indicted by the National Anticorruption Directorate for acting at the request of another defendant - Viorel Hrebenciuc - against Romsilva's interests with regard to the retrocession of over 40,000 ha.

3.3. PUBLIC PROCUREMENT CARRIED OUT BY STATE-OWNED COMPANIES - VULNERABILITY TO CORRUPTION

Public procurement is a vulnerable process for state owned companies, as shown by numerous, recurrent cases of fraud and corruption, with significant damages.

An analysis of public and annual reports and of information collected based on free access to information with regard to procurement plans, procurement procedures, top

46. CNADNR - agreements with law firms close to Dan Sova, *Realitatea TV*, 21 Nov 2015 https://www.realitatea.net/cnadnr-contracte-cu-case-de-avocatura-apropiate-lui-dan-ova_1835034.html

47. National Anticorruption Directorate Communicate, 26 January 2016 <http://www.pna.ro/comunicat.xhtml?id=7056>

48. CET Govora case: Dan Sova, sentenced to 3 years in prison, *Adevarul*, 25 September 2017 <http://bit.ly/2i9ymTQ>

10 clients and suppliers, revealed the following:

- public enterprises publish minimum information, in a closed format, difficult to access by independent monitors;
- for specific information, the management of these companies usually refer directly to the Electronic System for Public Procurement (SEAP), which, in its turn has limitations making it impossible to conduct a quick and independent evaluation, being designed as an operational tool, not as a monitoring tool;
- procurement plans and investment plans are not always published, and their application is not always transparent;
- a frequent practice is the use of subcontractors, which, although legal, raises concerns particularly about the difference in their scope of business, without connection to the product or service contracted by the subcontractor.
- there are significant delays in updating the SEAP with information on the successful bidders, of the procurement reports and often this differs from the information published on the website of the companies.

With regard to the procedures carried out by state-owned companies, the old legislation on public procurements caused contradictory interpretations about the capacity of contracting authority/ entity⁴⁹ of these companies. This capacity imposes observance of the legislation on public procurement, respectively on sectoral procurement. The lack of clarifications and clear criteria place these companies in a “grey area”, tempting for corruption and clientelistic networks.⁵⁰

Contradictory decisions of the High Court of Cassation and Justice concerning the status of contracting authority in the cases Romsilva 1 and Romsilva 2 revealed these interpretation issues related to the legislation on procurement.

In 2009, HCCJ ruled final acquittal in Romsilva 1, in which a former director, Ion Dumitru, had been accused of rigged, overvalued public procurements (with damages of 10 million lei), motivating that Romsilva does not have the capacity of contracting authority for the procurement of the respective products, “using its own funds, not public resources”.⁵¹

In Romsilva 2 - the procurement of a tank from a scrap metal yard in Ukraine with a mark-up of 1,700% and its transformation into “forestry machinery” never to be used - Ion Dumitru was acquitted in first instance by the 3-judge panel for the same reasons (*Romsilva* could not be considered a contracting authority, since it made the purchase using its own funds)⁵². However, in June 2013, the 5-judge panel of the HCCJ ruled a final 3-year suspended sentence for Ion Dumitru and the payment to Romsilva of 600,000 lei as damages. This panel considered Romsilva to be a contracting authority, and, consequently, it deemed it would have had to observe the legislation on public procurement.⁵³

49. This topic was also tackled in subchapter 1.3.3.

50. If a company set up by a town hall or a city hall will consider that it is not a contracting authority when making procurements, it will organise its own procurement procedures and it will use its own means to publicise them, which means that these procedures won't be available in the SEAP

51. The “*Romsilva*” Case - Ion Dumitru, *Hotnews*, <http://www.hotnews.ro/ancheta-7734156-dosarul-romsilva-ion-dumitru.htm>

52. *Why was Dumitru acquitted in the case of the Ukrainian tank*, *Evenimentul Zilei*, 7 February 2012, <http://evz.ro/de-ce-a-fost-achitat-ion-dumitru-in-dosarul-tancului-ucrainean-965323.html>

53. The former deputy Ion Dumitru - a final 3-year suspended sentence, *Mediafax*, 7 June 2013, <http://www.mediafax.ro/social/fostul-deputat-ion-dumitru-condamnat-definitiv-la-trei-ani-de-inchisoare-cu-suspendare-10939562>

The new legislation on public procurement adopted in 2016 is still quite recent, therefore there has not yet been a clarification of the situations when state-owned companies are contracting authorities/ entities, and when they must observe the provisions of Law 98/2016 (for traditional public procurement) and Law 99/2016 (for sectoral procurements).

Corruption cases related to state-owned companies included in our analysis

SECTOR	STATE-OWNED COMPANY	CRIMINAL CASE	DAMAGES	MECHANISMS
Communications	Poșta Română	Insurance policies for employees with fictional intermediaries	EUR 4 mil	Discretionary allocation of company funds Manipulation/ fabrication of needs
Communications	Poșta Română	Overvalued IT procurements	EUR 4.6 mil	Procurement without tender Overvalued price Manipulation/ fabrication of needs
Energy	The Oltenia Energetic Complex	Bribery for resignation of management member	EUR 28,000	Discretionary allocation of company funds Abuse of office
Energy	Hidroelectrica	"The Smart Guys at Hidroelectrica"	EUR 2.3 billion 2003-2013	Overvalued works Undervalued energy sales
Energy	Romgaz	"Cheap gas business"	EUR 92 mil	Undervalued energy sales Regulations
Energy	Transelectrica	"Transelectrica SMART"	EUR 46 mil	Discretionary allocation of company funds Overvalued contracts with affiliated companies
Environment	Romsilva	Illegal Retrocessions - Baneasa Farm and Sna-gov Forest	EUR 145 mil	Abuse of office Discretionary exploitation of public assets
Environment	Romsilva	Fraudulent procurement - tank and tranquilliser weapons	EUR 353,000	Fabrication of needs Discretionary allocation of company funds
Transport	CFR Călători	Overvalued preferential contracts	EUR 45,000	Procurement without tender Overvalued price Manipulation/ fabrication of needs

Transport	CNADNR	"Transalpina 1" - reporting and disbursement of fictional works	EUR 5 mil	Abuse of office Overvalued price Manipulation/ fabri- cation of needs
Transport	CNADNR	"Transalpina 2"	EUR 10 mil	Overvalued price Discretionary allo- cation of company funds
Transport	Port of Con- stanta	Pilotage and towage services	EUR 36 mil	Discretionary ex- ploitation of public assets Undervalued lease contracts
Transport	Port of Con- stanta	Administra- tive problems in contract management and personnel recruitment and selection	unidentified	Abuse of office Discretionary appointments and dismissals
Transport	Port of Con- stanta	Non-competitive practices	EUR 5 mil	Private state capture by a cartel of private companies
Public utilities	ELCEN / RA- DET	Bankruptcy due to poor gover- nance	EUR 900 mil	Lack of transparen- cy and wastage of public funds
Public utilities	RADET	Bribery for payment of the works	EUR 600,000	Abuse of office
Public utilities	RATB	Legal assistance contract	EUR 820,000	Abuse of office

Source: National Anticorruption Directorate releases; reports of the Control Body, Competition Council; tefuralafactura.ro

STATE-OWNED COMPANIES IN ROMANIA - 5 CONCLUSIONS AND 5 RECOMMENDATIONS TO PREVENT CORRUPTION AND STATE CAPTURE

Romania is currently the country with the largest number of state-owned companies in Europe. The Government is a majority stake-holder in approximately 250 companies, and local authorities own over 1,100. The exaggerated size of the public sector, the very large number of state-owned companies and their scattered distribution all across Romania make monitoring difficult and contribute to avoiding public scrutiny, creating opportunities for corruption and clientelism.

After 2011, following the adoption of G.E.O. 109/2011, the legal framework for corporate governance of state-owned companies improved significantly. The actions of the National Anticorruption Directorate and D.I.I.C.O.T. revealed the size of the fraud within such companies.

The country report drafted as part of the project entitled "Preventing corruption and state capture – state-owned companies" draws some conclusions and makes some recommendations.

5 main conclusions

- 1) The Romanian legislation on the corporate governance of public enterprises – G.E.O. 109/2011 and Law 111/2016 – follows the principles of the Organisation for Cooperation and Economic Development (OCDE). Even if it hasn't been applied in full, the current legislation brought significant improvement, in particular for larger companies, under the control of the central administration. At the level of local (utility) companies, both legislation enforcement and performance are lagging behind, when compared to those at central level.
- 2) There is a clear correlation between the quality of the corporate governance framework and the performance of state-owned companies. Following the improvement of the corporate governance framework in 2011, state-owned companies performed better. For instance, in 2016 companies in the "Fondul Proprietatea" portfolio distributed to the state budget dividends 12 times higher than before the adoption of G.E.O. 109/2011 - from 117 million lei to 1.4 billion lei.
- 3) The legal framework cannot be separated from sectoral reforms, since in the absence of these reforms, it generates limited effects. The positive effect of the general corporate governance framework was amplified by sectoral reforms - many under the pressure of the European Commission or the IMF - such as: liberalisation and increase in transparency in the energy sector, listing of some companies at the stock exchange, strengthening of certain regulations, tariff reforms for utilities.

We note that performance differs from sector to sector, depending on the strictness with which the corporate governance framework was enforced and depending on sectoral reforms. For example, the performance of Hidroelectrica improved significantly with the energy reforms and with the increase in transparency regarding the activity of the company, but the performance remained low in the case of CNADNR/ CNAIR, where no corporate governance framework was enforced, and where there were no sectoral reforms.

- 4) Aside from the improvement of the legal framework on corporate governance and the sectoral reforms, the success of anti-corruption prosecutors in several high-profile cases played a positive role. These investigations discouraged some practices such as unprofitable procurement (Romsilva, CFR) or undervalued sale (Romgaz, Hidroelectrica). The activity of the National Integrity Agency (ANI) discouraged conflicts of interests and incompatibilities. The National Anticorruption Strategy for 2016-2020 included corruption prevention measures in state-owned companies. But there are still vulnerabilities in the administrative control mechanisms (the responsibility of sectoral ministries, the activity of the Court of Accounts etc.).
- 5) As of 2017, there is a significant risk for most of the achievements to be lost again. Both the corporate governance framework and some sectoral reforms are taking important steps back. Law 111/2016 is not enforced in the majority of state-owned that were analysed. The Ministry of Public Finance has not published the analysis of the situation of state-owned companies for 2016 and it applies no sanctions

for non-observance of Law 111/2016, although this law is systematically infringed, for example, by “turning interim management into permanent management” in state-owned companies. In 2017, the exception which permitted control authorities to appoint interim directors or administrators⁵⁴ became a general rule.⁵⁵

To complete the budget, state-owned companies were forced to distribute to the state a minimum of 90% of their net profit (and not a minimum of 50%, as provided by the law) and, moreover, they were forced to distribute, as additional dividends, the undistributed profit of the previous years, which had been established as financial reserve. This had a significant impact on their investment capacity and on their long-term development.

We also took note of the recent set-up by the local authorities of many new state-owned companies, with unclear scope, status and applicable legislation. In Bucharest 22 municipal companies were incorporated and would receive more than 10% of the budget of the Capital city - without clear justification of the reason for their set-up, their duties, the criteria of appointment for the management or how they would be monitored.

5 main recommendations

1) Strict enforcement of the legislation on corporate governance and supplementation with the notion of Service of general economic interest

Although the European Commission commended the legal framework on corporate governance as being in line with “good international practices”, it was seriously endangered in 2017. We recommend abandoning any initiatives to amend Law 111/2016 for the approval of G.E.O. 109/2011, and the immediate and integral enforcement of this Law, both to existing state-owned companies and to new companies undergoing incorporation by local authorities.

The legal framework should be updated to include the definition of “Service of general economic interest” – which are economic activities which would not be supplies on the free market and justify the need for public intervention. Defining the notion of Service of general economic interest is essential for the adoption of a shareholding policy of the state, meant to explain state involvement in all state-owned companies, the exact reason for which the central and local authorities hold shares in the companies in their portfolio.

2) Monitoring newly incorporated companies set up by the public local administration

The set-up of new state-owned companies by local authorities should be carefully monitored and analysed, and not just in terms of application of the corporate governance principles. The incorporation of such companies without

54. Two new articles were added to Law 111/2016 approving G.E.O. 109/2011, which provide for the possibility of appointing “interim directors” and “interim administrator” for 4 months, until the completion of the selection procedure. If the procedure is suspended or cancelled, the interim mandates continue until the appointment of a new director or administrator

55. The Trojan horse. About the interim mandates of corporate governance, Hotnews, 12 October 2017, <http://economie.hotnews.ro/stiri-companii-22050233-calul-troian-sau-despre-interimatele-guvernantei-corporative.htm>

an objective justification should also be the focus of the Competition Council, as it represents a return to the past, against the spirit of the Constitution which defines Romania as a “market economy, based on free initiative and competition”.

If there is proof that the incorporation of these companies is necessary, that it comes in response to a need to provide a service of general economic interests, then there is no reason to except them from the rules of corporate governance applicable to all state-owned companies. This means competitive and transparent selection of management, transparency of their duties through the Letter of expectations, transparency of budgets, performance criteria and monitoring by the City Hall/ Town Hall, with the possibility of having an independent verification from the public, with full publication of all relevant information regarding their operation.

3) The need for a clear mechanism to assign responsibilities and monitoring duties

The Ministry of Public Finances and public control authorities share this responsibility, but monitoring and performance evaluation is often formal, inconsistent, without giving any feedback. State-owned companies in Romania should draw up reports more often and should make them more flexible.

Political instability puts additional pressure on the continuity and consolidation of institutional practices. Frequent changes in political leadership generate uncertainty and institutional bottlenecks within the institutional architectures of public control authorities and within company management. This inconsistency blocked the development of internal mechanisms for monitoring and evaluation within public control authorities.

4) The minority shareholder – “a change agent”

The minority shareholder is often seen as a “change agent”, a “pressure factor” in the sense of observing the requirements of corporate governance. Unlike companies where the state owns 100% of the shares, companies with minority shareholders are, generally speaking, under more pressure to be professional, more concerned with making a profit. It would also be useful to involve partners from the civil society in the monitoring of state-owned companies (at least from a procedural standpoint), as it would have the advantage of involving a greater number of experts, aside from the staff of specialised public units.

5) Combating state capture networks: success stories and limitations of the criminal approach and the need for prevention

Although essential to limiting the temptation of corruption, the mere actions of the National Anticorruption Directorate or of D.I.I.C.O.T. cannot solve the problem of state-owned companies. Criminal action is only part of the solution. The standard of proof of the criminal action - “beyond any reasonable doubt” - is, realistically speaking, hard to achieve in many of these situations. On the other hand, the Constitutional Court limited the scope of application of the abuse of office, to

include only those acts committed in non-observance of the primary legislation, which exempted from criminal liability a series of decisions made with infringement of government decisions, the job description or operating regulations. Many controversial decisions, causing important damages, inopportune procurements or investments, although obvious to the naked eye, they are not crimes and they can never be proven "beyond any reasonable doubt" before a judge.

That is why, it is necessary to have preventive mechanisms and intermediary measures, to apply other types of sanctions aside from criminal sanctions. An example worth considering is that of the sanctions applied by the Competition Council.

The National Anticorruption Strategy 2016-2020 is based on this paradigm shift, with an accent on prevention and education, aside from law enforcement actions, and any new corruption case is considered by the authors of the new strategy "a management failure". The non-enforcement or the amputation of the legislation on corporate governance will lead to the spread of such "management failures",⁵⁶ and, implicitly to numerous corruption problems.

56. "It is not enough to fight corruption only through the force of the state and through the extraordinary action of the National Anticorruption Directorate", the paradigm shift "involves accountability on a managerial level". Any new case investigated by the National Anticorruption Directorate or ANI, is, without a doubt, a management failure." Raluca Pruna, 19 July 2016, <http://www.justitiecurata.ro/accent-pus-pe-prevenirea-coruptiei-ciolos-si-pruna-anunta-schimbarea-de-paradigma-in-strategia-anticoruptie>

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