Executive Summary

This Functional Review (the Review), undertaken for the Government of Romania, reflects the importance of Romania's transport industry to the economic and social life of the country. During its early transition years, Romania implemented radical structural reforms in the institutions of the transport sector, but over the last decade there has been concern that these changes have not led to tangible improvements in transport policy administration nor in the efficiency and effectiveness of the main delivery institutions in the railway and road sectors. The implications of the unfinished reforms are not negligible: poor prioritization leads to high and unsustainable fiscal costs, significant grant funds from the European Union (EU) are underutilized, and transport infrastructure and services are far below the expectations of Romanian citizens and European quality standards negatively impacting Romania's competitiveness in the European market.

The Review has tried to discern the main reasons for these shortcomings and to identify remedial actions. It focuses on three main challenges: the administration of the transport sector as a whole; the corporate governance of state-owned road and railway companies; and the priorities for the companies themselves. Attention is also given to budgeting issues and opportunities for greater private sector participation.

At the administrative level, the Review notes the lack of a comprehensive policy framework in the transport sector. It recommends that the **Ministry of Transport** (MOT) prepare a medium-term Romanian National Transport Strategy to chart a clear policy framework and a realistic public resource envelope for the industry through the difficult years ahead. The Review also recommends a restructuring of the administrative apparatus of the MOT to reduce current fragmentation of, and overlaps in responsibilities; and to separate the MOT's potentially conflicting policy-making, regulatory, ownership, and client roles. The creation of a multi-modal Strategy and Policy Group within the Ministry would also contribute to greater consistency in the administration of, investment in, and cost recovery of the road and railway infrastructure.

The Review finds that the **Corporate Governance** of the four main state-owned companies in road and railway sectors is seriously flawed, failing to meet most of the criteria for good governance such as those suggested by OECD Guidelines on State-owned enterprises. An absence of strategic vision and commercially-skilled guidance by their Boards, which are overwhelmingly dominated by MOT career officials—in many cases with political backing—has either permitted and/or contributed to a long-term decline in many of the companies' key performance indicators. Corporate Governance could be improved, as in many countries, by dividing the onerous burden of ownership responsibility between the MOT (which is sometimes politically conflicted by transport company decisions) and another ministry; and also by the nomination of smaller but more professional and more independent Boards of Directors. The new independent Board members should bring a wider range of technical and professional skills than available within the MOT alone, so that the Board is better able to give the companies the long-term support and guidance they need. The Boards should also have a mandated role in selection of the Chief Executives. The selection of Chief Executives should be based on merit and their appointment be made through fixed-term management contracts with explicit performance targets.

In the case of the **National Company for Motorways and National Roads** (RNCMNR), apart from the governance recommendations, the Review finds a need to enhance the relationship between the State and the company through a Performance Agreement. It is also necessary to bring to the company modern corporate management practices. Moreover, the highway planning and engineering design functions must be strengthened, and the investment and operations lines of business must be streamlined with greater delegation to regional offices. The cost-effectiveness of road maintenance can be improved by shifting to a road asset management approach, for example through long-term contracts based on performance criteria.

The condition and reliability of rail infrastructure assets is declining and will continue to do so if the level of public funding which is likely to be available over the next few years is applied to a network of the current scale. The Review urges the national railway infrastructure company, **CFR SA**, to work with the government and train operators to identify and evaluate realistic options for a financially sustainable network that can properly serve the core markets in which railway services may have long-term competitive advantage. Based on such an assessment the Government and the MOT should make a decision on a more affordable public network. However, even with a more affordable public network and efficiency improvements, the Review finds that the railway infrastructure network, like the road network, will require stable long-term support from the Romanian budget.

The Review examined the railway Passenger Services Contract (PSC) between the government and the state-owned railway passenger company, **CFR Călători**, and noted that it contains few incentives for service rationalization, efficiency improvements or revenue enhancement. The average number of passengers per train has declined over ten years from 170 to about 90. Staff productivity has declined by a quarter over the same period, railcar utilization by a third. The Review suggests that the PSC should be redesigned to create a range of operational and commercial targets and incentives. The Review also notes that the very low passenger flows on many branch lines is neither an efficient use of expensive train-sets nor environmentally-friendly. An integrated network of rail and connecting bus services could provide much better value for money and lower greenhouse gas emissions. Publication of the existing average subsidies per passenger on Romania's public and private passenger railway routes would pinpoint the opportunities.

In the rail freight sector, the Review notes the emergence of a vibrant private rail freight industry in Romania. But it expresses concern at the declining labor and equipment productivity—about half of what it was ten years ago—and dire financial situation of the state-owned rail freight operator, **CFR Marfă.** Under the MOT's governance since 1998, CFR Marfă has been more and more squeezed between a deregulated road freight haulage industry and a private rail freight industry. It seems unlikely to survive without a more selective and aggressive business model, which in its turn is unlikely to be adopted under the existing state ownership. CFR Marfă remains one of the largest freight transport companies in the region, with potentially valuable skills, assets and customer base. The Review recommends that it be privatized in a way that will give it the commercial freedom and opportunity to contribute positively to the rapidly changing European rail freight market. The government has started the due diligence process for such privatization.

On the issue of **Public Budgeting**, the Review notes that Romania's current annual program of transport infrastructure investment mostly contains projects that are either not funded, not started or uncompleted. The *authorized* annual expenditure on capital works that is implicit in this program is many times greater than what has traditionally been spent, or than what is actually available to be spent. But at the same time, only a small fraction of EU funds that are already pledged for Romanian transport infrastructure have actually been used. The Review believes that the current program needs to be re-established on a realistic basis—using the three-year ceilings in the Government's fiscal strategy as a start—and that in the future its assembly be more disciplined in the adoption and prioritization of projects. To obtain maximum leverage from scarce domestic funds, there is a strong case for immediate priority to be given to those projects for which EU funds are also available.

The use of **European Cohesion and Structural Funds** available to the Romania's transport sector—about EUR 4.6 billion between 2007 and 2013—could have significantly boosted the funding of transport investments during a period of severe fiscal stress in Romania. However the MOT and the implementing entities have been unable to utilize such grants and there is a strong probability that only a fraction of those funds will now be used before the end of the planning period in 2013/15. The inability of Romania to exploit the funds allocated by the EU for transport is due to the same sector governance, corporate governance, and company management issues that are the subject of the present Review. There may be temporary fixes to enhance the administrative mechanics for the use of such funds, but as long as the fundamental issues covered by the Review are not addressed, the chances of using these funds within the current deadlines will remain limited.

Finally, the Review supports Romania's early confidence in **Private Sector Participation** in road and rail transport services through deregulation, which led to growth in both the private bus and private road haulage industries, and by the licensing of private train operators to use Romania's railway system—Romania now has one of the highest proportions of private rail freight operations in Europe. However, attempts to attract private financing to the more challenging sphere of transport infrastructure, through the specialized mechanism of PPPs, have not been successful. Policies for encouraging private sector participation in transport services and infrastructure should be included in Romania's National Transport Strategy. The Review suggests options such as in the provision of integrated rail/bus systems, the piloting of private concessions for regional passenger railway services and the use of performance-based contracts for road maintenance. The Review foresees a role for PPPs for simpler and less costly highway projects than what has been attempted so far, and for other sectors such as airports. However, PPP projects are unlikely in the near future to yield more than a fraction of the funding already available from the EU grants pledged to Romania—if the transport infrastructure program and administration are refocused to use these grants.

Summary of Findings and Action Plan

Background

1. The Functional Review (the Review) was undertaken by the World Bank for the Government of Romania (GoR). The Review's focus in the transport sector has been the Ministry of Transport and Infrastructure (MOT) and the four largest companies for which MOT acts as the sole shareholder on behalf of the State: the Romania National Company for Motorways and National Roads (RNCMNR); the National Railway (Infrastructure) Company (CFR SA); The National Railway (Passenger) Company (CFR Călători); and the National Railway (Freight) Company (CFR Marfã).

2. During its early transition years, Romania implemented radical structural reforms in the transport sector, but the reform process seems to have lost momentum over the last decade. The Review has, in five main areas of investigation, tried to discern the underlying reasons and to identify remedial actions. The five areas are:

i. Sector Governance: how the MOT discharges its public interest responsibilities in the transport sector.
ii. Corporate Governance: how the four main companies are directed and monitored by their Shareholder and Boards of Directors.
iii. Management priorities within the four companies.
iv. Strategic issues in transport financing and budget determination.
v. Opportunities for private sector participation (PSP).

3. The findings and recommended actions in each area are summarized below. Many of the actions stated are urgent and need early implementation, but they will take some years to bear fruit. Complex and systemic administrative and governance problems will not be solved overnight. The objective of the recommendations is to strengthen the MOT to perform its public interest functions, and to improve the governance and functionality of the four companies to fulfill their specific mandates.

Sector Governance

4. There are strong public interests in the performance of the transport industry that justify governments playing a major role in the sector. Government actions, or lack of actions, are therefore always influential and often decisive in encouraging or hindering a successful transport industry. The Review considers that there are several flaws in transport sector governance in Romania:

- The absence of a convincing and policy-oriented multi-modal national transport strategy that can guide both public and private participants in the industry in the difficult years ahead.
- An unclear division of roles between the MOT and the road and rail infrastructure companies, an asset accounting framework in these two companies which is not well

geared to publicly-funded assets, and inconsistent treatment in road and rail funding and cost recovery policies.

- Insufficient road infrastructure cost recovery (road user charge mechanism) that is inconsistent with EU recommendations; and neglect of other public roads (county and village roads).
- Retention of CFR Marfă in a government-constrained straitjacket while having deregulated the private road haulage industry and the private rail freight industry, with both of which Marfă has to compete.
- Signing by government of a Public Service Contract (PSC) with CFR Călători that is un-incentivized for efficiency, obscure in its distribution among passengers, and clearly unaffordable to the public purse.
- Insufficient clarity of roles and distance between the regulatory watchdogs and both the regulatory policy makers on the one hand, and the regulated parties on the other—for all transport modes.
- A ministry that is modally and functionally fragmented into numerous directorates, is tactical and reactive in its approach; and the balance of influences that must necessarily mould its deliberations and conduct—the political and the technical—seems to be disproportionately skewed to the former.

5. Table 1 shows a recommended Action Plan, for either Government or MOT actions.

Table 1: Recommended Action Plan for Sector Governance

Area of Sector Governance	Summary of Short-term Actions	Summary of Medium and Long-term Actions
1. Strategy & Policy	MOT to prepare and publish a brief but realistic medium-term national transport strategy covering strategic objectives, policies and proposed programs for the next 5 years.	The national transport strategy should be updated periodically.
2. Main State Institutions for transport delivery	Government to privatize CFR Marfă as soon as possible in a way that will allow it the opportunity to successfully compete on equal terms in the freight transport industry.	Government to consider reconstituting CFR SA and RNCMNR as infrastructure delivery, management and maintenance companies: asset ownership and strategic direction of the rail and road networks themselves falling directly to (and appearing within the accounts of) the State.
3. Purchase of services on behalf of the State	(a) MOT to work with CFR Călători to negotiate an Affordable multi-year PSC, with built-in efficiency incentives. (b) On a trial basis, MOT to draw up	(a) Government to adopt an alternative fare concession and regulatory policy that gives CFR Călători more commercial flexibility and revenue incentive.

	PSCs for social transport services on a number of branch-lines, and let the contracts by competitive tender to properly qualified private bus service operators.	(b) On a trial basis, MOT to create a separable pilot regional passenger railway company from a segment of CFR Călători's regional (non inter-city) operations and award the PSC contract of that company by competitive tender to a properly qualified and licensed private railway company.
4. Regulatory functions	Government to establish in another ministry an effective railway regulatory function to oversee the implementation of and disputes concerning the application of track access rights and charges.	(a) MOT to determine the matters of regulatory strategy and policy that should be the responsibility of the policy directorates of MOT. (b) MOT to consider establishing a multi-modal *Transport Licensing and Safety Agency*.
5. Administrative apparatus	MOT to transfer the functions of general medical and social assistance and hospitals to the ministry responsible for health, with occupational health matters transferred directly to the companies.	(a) Government to reorganize the MOT into more substantial and multi-modal General Directorates that will help reduce gaps and overlaps in functions. (b) MOT to enhance financial and human resource management in line with broader recommendations for the Romanian public administration.
6. Performance Agreement with RNCMNR	MOT to establish an annually reviewed Performance Agreement with RNCMNR with multi-annual perspective and budget envelope.	MOT to give RNCMNR freedom to manage within the Performance Agreement.

Corporate Governance

6. Romanian Company Law was used to reconstitute the three transport delivery entities in the rail sector (in 1998) and that in the road sector (in 2004). This was to facilitate their 'arm's length' distance from both the necessarily bureaucratic structures of government ministries, and the influence of short-term fluctuations in political aims. Both are legitimate features of government but their undiluted impact is inimical to the focused long-term planning and operational management necessary to deliver transport infrastructure and services efficiently and effectively in an environment of changing and challenging market demands. Corporatization can facilitate the dilution, but is not sufficient. Some critical reinforcements in corporate governance were omitted from the institutional architecture at its inception, and have not been rectified since. The result has been that the four transport entities have not migrated to become autonomous state-owned companies responsive to their 'markets', but have remained branches of MOT reincarnated in corporate form.

7. This sector and governance structure has not prevented corruption as perceived by various stakeholders interviewed during the course of this Review. Corruption remains a key challenge for the transport sector in Romania.

8. For a decade and longer, each of the four companies has faced different but very significant external market challenges within difficult resourcing constraints, but they have consistently failed to respond to these challenges. Short-term company mistakes can be put down to many causes: sudden market changes, poor individual management decisions, trade union actions, corrupt decisions and so on. But when serious flaws in basic corporate strategy endure over such a long period, the responsibility resides clearly with the Board of Directors and the Shareholders, as the Board's role in a joint-stock company is to establish and monitor the company's direction and strategy, and the Shareholders' role is to select the Board.

9. These roles have been performed almost exclusively by the MOT, on behalf of the State, for the last decade. A combination of overwhelming Board domination by MOT delegates (9 of 11 Directors in the case of railways), the reserved rights of the MOT-dominated Assembly of Shareholders (4 of 5 members), and selection of the Chairperson and CEO through the political patronage of the MOT has effectively closed, or rather never allowed to open, an 'arm's length' distance between the MOT and the companies that their corporate form was meant to facilitate. The companies have been squeezed between the external pressures of market change and the internal inertia of political and bureaucratic control.

10. The companies currently have no robust medium-term business or corporate plans and, so far as can be judged, their Boards and Shareholders have not seen the need to ask for one. Another symptom of inertia is in regard to the seventeen subsidiary companies that the three rail companies have collectively established, mainly for cosmetic reasons. Some contain core competencies that have little logic for separation. Others are non-core but there are no plans to divest them. For the most part, the subsidiaries neither compete with private companies for the contracts that they receive nor earn any significant income from external customers. Tackling sector governance problems is a necessary condition for any serious reform. Table 2 sets out the Review's recommendations to improve corporate governance, all these actions require immediate attention.

Table 2: Recommended Action Plan for Corporate Governance of the four companies

Area of Corporate Governance	Summary of Actions
7. Shareholdings	Government to (a) delegate stewardship of a majority of the companies' shares to another ministry; (b) change the balance of the Assembly of Shareholders accordingly, and (c) restrict the number of matters on which the Assembly has immediate endorsement or veto over Board Decisions. MOT to manage shareholdings through a new specialist Directorate with a mandate confined to long-term stewardship of public shareholdings (See section 2).
8. Boards of Directors	Government to encourage creation of smaller, more independent and more professional Boards and require a majority of Board Members to be

	independent of the shareholding Ministries.
9. Chief Executive Officers	Government to (a) Separate the roles of CEO and Chairperson of the Board; (b) Require that CEOs be selected by a merit-based process with defined Board involvement; and (c) Introduce minimum fixed-term management contracts for CEOs with performance targets.
10. Corporate or Business Plans	Government to require the Companies to present annually to the shareholding ministries the company's medium-term Corporate or Business Plan, <u>prepared by Management and Adopted by the Board</u>, that is financially feasible and consistent with any Performance Agreement (in the case of CFR SA and RNCMNR) or Passenger Service Contract (in the case of CFR Călători) with the Government.
11. Transparency and Disclosure	Raise the minimum requirements on annual reporting and disclosure of information, and mandate annual external independent audit in accordance with international accounting standards.
12. Subsidiary companies	Rail companies to commission an independent appraisal of their subsidiaries to determine whether to retain, divest or reincorporate them under core business management.

Strategic Priorities for Company Management

11. **CFR Marfă:** the Review finds the priority to be for the Company's executive management to prepare for privatization. CFR Marfă remains one of the biggest freight transport companies in the region, with valuable skills, assets and customer base. It is likely that a private investor will want the company to pursue rail freight markets more selectively, more aggressively and from a higher productivity base. The government should take steps to ensure that CFR Marfă's professional managers and key operational staff are retained and motivated to support a successful privatization.

12. **CFR Călători:** the priority for management is to prepare a rail passenger service specification that would reduce the real cost of state support for the passenger rail PSC. Much of the data and conceptual planning required has already been provided by an Italferr Consultancy, which estimated savings in net cost to the government of about a quarter. In carrying out this task, CFR Călători should nominate a number of routes where low passenger flows and high costs/passenger-km mean that social service could be better met by pilot PSC contracts between MOT and private bus companies.

13. **CFR SA:** even with efficiency improvements, the finances of the company cannot be brought into a reasonable long-term balance without either a large increase in government budgetary support or a significant reduction in the network that CFR SA is required by the government to manage and maintain (or both). These are primarily decisions for the government, but CFR SA has a lead role to play with the MOT and train operating companies in preparing—through a Task Force—the analytical basis for such decisions. The Task Force should recommend to the government a smaller network of higher average traffic density that will protect core passenger and freight markets, but give Romania a railway network more

commensurate with its traffic flows and with the comparative advantages of rail, and on which a sustainable 21st century railway industry can be rebuilt.

14. **RNCMNR:** a number of actions are recommended to improve the management of the company and its activities including the role of regional offices. The short-term priority is to adopt traffic flow/condition-based routine and periodic maintenance prioritization.

Table 3: Recommended Action Plan for Company Management

Company	Short-term Actions	Medium and Long-term Actions
12. CFR Marfă	Management to prepare for early privatization; MOT to try to ensure key managers and staff are retained for future company success.	
13. CFR Călători	Management to propose to the MOT a detailed service specification building upon the ideas and proposals contained in Italferr Report, with a view to reducing PSC cost by a quarter.	Subject to Government adoption of a more flexible and targeted fare regulatory regime, Management to develop and implement a more market oriented fare structure and system.
14. CFR SA	Management, with the MOT and train operating companies, to develop and evaluate the alternative options to attain a long-term financially sustainable and competitive core rail network based on market and commercial criteria.	Government to make a decision on a smaller network of higher average traffic density that will protect core passenger and freight markets, but give Romania a railway network more commensurate with its traffic flows.
15. RNCMNR	(a) Management to review the functional classification of roads and develop design, structural and maintenance standards by functional and traffic volume classes. The maintenance standards should be developed as the first priority. (b) MOT and Management to develop and conclude budget constrained Performance Agreement and put in place an annual cycle of performance monitoring on the basis of the Performance Agreement.	(a) Management to articulate a vision and mission statements for RNCMNR consistent with the updated national transport strategy (Section 2.2). (b) Revise organization structure to be consistent with its mission, including planning, programming, evaluation and road safety. (c) Mainstream the use of the company's road asset management systems in resource planning.

Funding and Budgeting

15. Domestic funding for the transport sector in Romania comes from general tax revenues, infrastructure usage fees and transport service tariffs. For a number of years, but compounded by the current circumstances, public expenditure programs in transport have far exceeded funding availability.

16. At the same time, the MOT and the companies have been unable to utilize more than a fraction of EU transport grants due to the sector governance, corporate governance, and company management issues identified in this Review, and highlighted by weaknesses in administrative capacity and inadequate funding priorities given to other domestic projects.

17. The inability to satisfactorily prioritize and manage projects over the last few years has meant that funding of new projects has been spread too thinly. A ballooning capital investment program has been overloaded with unfunded or inadequately funded projects. The total 'authorized' annual capital expenditure for all modes of transport in 2010 was more than six times the MOT's total annual budget and more than eight times the previous average annual capital expenditures.

18. There is also a mismatch between resources devoted to capital expenditures vis-à-vis recurrent expenditures. For example, in 2009 the cost to the state budget of the PSC contract for passenger rail services, which was insufficient for CFR Călători to pay its infrastructure charges, was twenty times the direct budget contribution towards maintenance of the rail network. As four-fifths of train-kms are run to meet the PSC; the government is therefore actually 'paying for' the steady deterioration of public assets. In the road sector funding for building new road capacity exists alongside major shortfalls in maintenance of the existing road network.

19. Infrastructure cost recovery is particularly low in the road sector. Between 2006 and 2009 revenues from the Rovignette system covered an average of about 10 percent of total outlays on national roads (including construction), and none of the other public roads. RNCMNR has now committed the full Rovignette revenues until at least 2016 to service debt on expensive supplier credits from commercial banks loans, leaving RNCMNR with no direct source to fund maintenance activities.

20. The recommended action plan is summarized in Table 4.

Table 4: Recommended Action Plan for Transport Funding

Topic	Short-term Actions	Medium and Long-term Actions
15. Public investment management	(a) Rationalize MOT's public investment program, discard some projects and defer others to future years, therefore creating fiscal space for Romanian counterpart funding of EU funded transport projects, which should be given priority. (b) Increase road user charges to strengthen funds available for road maintenance and to attain more equal ratios of road and railway infrastructure	(a) Rebalance the resources devoted to capital expenditures and recurrent expenditures in both railway and road sectors. (b) Bring together the planning and budgeting of public funding for roads and railway infrastructure and relate to the integrated Transport Strategy (Section 2.2). (c) Restructure the road sector budget to be policy-oriented allowing expenditures to be

	cost recovery from users. MOT and RNCMNR undertake a Road User Charge study, including an evaluation of alternative ways to collect the charges. (c) Prohibit further pledging of Rovignette revenues.	mapped onto budget categories. (d) RNCMNR Management to establish a time table for installing an electronic road user charge technology covering all public roads.

Private Sector Participation

21. Private sector participation (PSP) is the involvement of the private sector in a transport-related activity traditionally carried out by a State authority or company whether through license, lease, joint venture, contract, franchise or concession agreement. A public-private partnership (PPP) is a specific form of PSP and, though there is no single definition, it generally refers to a time-bound arrangement with a private company for the provision of public assets and/ or related services, where there is a substantial risk sharing and the private sector receives performance-linked payments.

22. Romania showed early confidence in the private sector in road and rail transport services through deregulation of both the private bus and private road haulage industries, and by the licensing of private train operators to use Romania's railway system (Romania now has one of the highest proportions of private rail freight operations in Europe).

23. MOT also attempted at various times to attract private financing to the more challenging transport infrastructure sector, particularly major highway construction. However, for various reasons described in Section 6, the attempts in the road sector have all failed. Improved policies for PSP in the transport sector, including more modest but achievable PPP projects, should form an integral part of the Transport Strategy that is proposed in Section 2.

24. Even if successful, PPP projects cannot in the foreseeable future yield more than a fraction of the funds already pledged to Romania by the EU, if Romania were able effectively to spend them. However, the range of PSP opportunities is much wider than PPP alone, and the benefits of private sector involvement are more far-reaching than just access to capital. Priority actions are set out in Table 5.

Table 5: Recommended Action Plan for Private Sector Participation

Topic	Short-term Actions	Medium and Long-term Actions
16. Private Sector Participation	(a) Ensure PPP law guarantees quality of preparation, competitive procurement, and transparency in decision making. (b) Implement pilot performance-based road rehabilitation and maintenance contracts. (c) Adopt smaller and less complex road network enhancement projects for PPP. (d) Rail sector proposals for PSP as	Increased PSP may follow from independent business appraisal of the seventeen subsidiary companies owned by the three main railway companies: some of these could be privatized and the services they provide competitively procured. Other sectors such as airports can be proposed for PPPs

	already described (privatization of CFR Marfã, rail passenger services contracts by PPP, and private bus PSC contracts)	

1 Introduction

1.1 Objectives of the Review

1. The Functional Review has been undertaken by the World Bank for the Government of Romania (GoR). Its purpose is to help the government develop a series of action plans to implement over the short and medium term to strengthen the effectiveness and efficiency of Romania's public administration in a number of areas, especially those functions that support Romania's implementation of the Lisbon Strategy.

2. In the transport sector, which is the subject of this Report, the Bank's focus is on the Ministry of Transport and Infrastructure (MOT) and the four largest companies of which MOT is the sole shareholder, on behalf of the State: the Romania National Company for Motorways and National Roads (RNCMNR); the National Railway (Infrastructure) Company (CFR SA); The National Railway (Passenger) Company (CFR Călători); and the National Railway (Freight) Company (CFR Marfã). There are other organizations that are subordinated to or report to the MOT for which broader recommendations are made.

3. Under the Memorandum of Understanding between the European Commission and Romania, the implementation of specific economic policy actions is envisaged. Policy actions directly related to the transport sector fall under the "Structural Reforms" set of actions and they are summarized below, with the original dates by which such actions were to be taken:

- Action plan for the restructuring of MOT and implementing agencies adopted; (by 2009Q4);
- The government adopts an action plan, which includes milestones and an implementation timeline, based on the outcome of the independent functional review (by 2010Q2);
- Restructuring of MOT and implementing agencies finalized (by 2010Q2)
- Progress with the implementation of the action plan, based on the outcome of the independent functional review (by 2010Q4 and 2011Q2).

1.2 Background

4. There are many ways in which the administration of transport in different countries is organized, depending upon administrative traditions and culture and on the policies which governments wish to implement. State transport institutions have traditionally been concentrated in one or a few government departments or ministries, amalgamating different functions which have sometimes covered the full spectrum from policy formulation to final service provision. In the past decades, progress has been made in European Union (EU) countries and internationally to separate the roles of transport policy and regulation from those of transport delivery institutions. More recently, several countries in Europe—including member states of the EU—have undertaken many changes to enhance the organizational effectiveness of the transport sector's institutions.

5. During its early transition years, Romania implemented significant and at that time radical structural reforms in transport sector institutions that were coherent with the principles of

separation adopted in the EU. But over the last decade there has been concern that these changes have not led to tangible improvements in transport policy administration nor in the efficiency and effectiveness of some delivery institutions. The Functional Review has endeavored to discern why this is so and to identify actions to overcome the deficiencies.

1.3 Method of Approach

6. The Transport Sector Functional Review (hereinafter 'the Review') covered the relationships and the accountability mechanisms in the provision of transport infrastructure and services. The Review adopted a top-down approach to the task, that is starting with overall transport sector governance and working down to individual institutions' performance; it also addressed broader cross-cutting issues in the transport sector, including sector budget and financing and opportunities for private sector participation. The structure of the Report follows this approach and is organized as follows:

7. Section 2 summarizes the Review's findings with regard to issues of Sector Governance; that is, how the government, mainly through MOT, manages the public interests in the transport sector as a whole.

8. Section 3 deals with issues of Corporate Governance; that is, how the four main companies that were set up in 1998 are directed and monitored by their Shareholder and Boards of Directors in their functions of delivering transport infrastructure and/or services.

9. Section 4 addresses key findings about the corporate management of these companies and how they organize their activities. Because this is a functional review of the transport administration, rather than a detailed company appraisal, the issues investigated are confined to higher level management matters, rather than detailed business processes.

10. Section 5 deals with some of the strategic issues and pressing problems of budget and financing in the transport sector.

11. Section 6 outlines some possibilities for private sector participation (PSP) in the transport industry that might help improve sector management and performance, while at the same time contributing to investment and operational funding needs.

12. Section 7 sets out a draft matrix of recommended priority policy actions.

13. Technical Annexes include details of some of the Review's proposals.

2 Sector Governance

2.1 Main Roles of Government in Transport

14. There are strong public interests in the performance of the transport industry that justify governments in playing a major role in the sector. Government actions, or lack of actions, are therefore always influential and often decisive in encouraging or hindering a successful transport industry. In this Review it is presumed that these public interests are: that the transport industry should be efficient; that it should be responsive to market needs; that it should be affordable to the public purse; and that it should be safe and meet the country's environmental standards.

15. Governments pursue these public interests through the performance of six main roles:

- Setting overall transport strategy and development objectives and implementing corresponding policies (including funding policies, which are dealt with in more detail in Section 5);
- Determining the main institutional forms of the public entities in the industry;
- Purchasing social transport services on behalf of the public;
- Regulating the industry (including economic, safety and environmental regulations);
- Administering international transport agreements and relationships;
- Setting up the apparatus of transport sector administration: in other words, organizing the MOT to perform its various roles.

16. The remainder of Section 2 summarizes the Review's findings in each of these areas.

2.2 Strategy and Policy

17. MOT does not have a documented multi-modal transport strategy that is consistent with a realistic assessment of the budgetary resources to sustain it over the next few years. As a result, at a time of financial crisis in the Sector, there is great uncertainty within the MOT, the state-owned delivery institutions, and the private sector, about where the sector is headed, what policies may be expected by them, and what is expected of them. Most other strategic documents were prepared in 2008 or earlier, or are concerned with establishing a desired program of investments in major projects, or relate to a particular mode. The policy content of such plans is usually absent or rather limited.

18. Transport strategy is about articulating industry-wide objectives, adopting consistent principles for attaining them and setting priorities in the use of public resources to support them. The modally-based administrative structure of the MOT at best does not encourage and at worst hinders the development of a coherent overall transport strategy. Aviation and maritime transport policy and infrastructure matters are both organized as General Directorates. Railway and Road transport (despite being far larger industries) are entrusted to two separate lower level Directorates. And there is a separate General Directorate for Road Infrastructure and Concessions.

19. Given the severe and worsening financial position of the transport sector a realistic national multi-modal transport strategy should be developed as a matter of urgency, linked to a realistic estimate of budget resources. It should set out clearly for at least the next five years the strategic aims of and policy settings for pursuing the public interests and fulfilling the government roles in a time of stringency, prioritization and difficult choices. It should not be an excessively long or technical document nor be dominated by a capital investment plan (though it might usefully indicate a realistic medium-term program for all modes that is consistent with a prudent estimate of financial resources likely to be available from national, EU and private sources).

20. Annex 1 describes the issues that such a Strategy might address. The remainder of the Review recommends some of the measures that the government might consider for inclusion in the national transport strategy.

2.3 Transport Industry Structure

21. The second role of government in its governance of the transport sector is to establish the form and scope of any state institutions involved in transport service or infrastructure delivery. This Functional Review is focused on four main state-owned transport delivery institutions. CFR Marfã and CFR Călători are rail transport services companies. CFR SA and RNCMNR are transport infrastructure companies. The railway companies and RNCMNR were established in 1998 and 2004 respectively as joint-stock companies under Romanian corporate law, 100 percent owned by the State, which delegates the stewardship of its Shareholding to MOT.

22. There is a difference in the economic context in which the two transport services companies operate compared to that of the two infrastructure companies. The former companies work in highly competitive service markets, dealing directly with consumers, and they are expected and able (in principle) to recover a substantial proportion of their own service delivery costs from final customers. They are clearly 'businesses' and the Review finds that the current company form is an appropriate one for such businesses.

23. By contrast, each of the infrastructure companies has near-monopoly control over the public infrastructure networks which have been trusted to them by the state to administer, neither company has direct relationships with the final beneficiaries of that infrastructure, and both inevitably rely mainly on taxpayer (Romanian and EU taxpayers) funding for network development, major rehabilitation and in practice even maintenance costs.

24. While supporting the basic concept of a company structure, the two public Infrastructure Companies are not 'businesses' in the commercial use of the term, but effectively service companies delegated to deliver, manage and maintain public infrastructure. The Review is not persuaded that they are optimally constituted to reflect their actual scope of responsibility and accountability to the public which owns and largely funds the development and preservation of their assets. One option is to reconstitute them not as quasi-owners of the huge infrastructure assets that dominate their balance sheets, but as delivery, management and maintenance companies. As such they would be contracted by the State to look after the State's respective rail and road networks, but the ownership of the network assets would fall to (and appear within the accounts of) the State itself or a specialist entity of the State.

25. In this model the MOT would have more explicitly the responsibility for determining strategic directions and main priorities for the network development and negotiating (multi-) annual agreements with the companies to deliver on them and on the service levels agreed with the companies within the agreed budgets or public service contracts and productivity targets adopted by the Boards. This option would bring together the responsibility and accountability for public infrastructure network development, service levels and funding within the strategic role of the State, instead of being fragmented between the MOT, the companies and the cracks in between; it would facilitate more consistent decisions in cost recovery policies and the balance of public funding between road and rail networks; it might diminish the role of ambit claims in establishing investment programs which are currently initiated by the companies and cut-back by the state; and each company's financial accounts might be less distorted by the difficulties of applying corporate accounting and auditing techniques to long-term public assets under the stewardship of non-profit making entities. Recasting the corporate form of the infrastructure companies requires fuller investigation of options and it is arguable that this is not the time to divert the attention of managements from the pressing challenges that beset them. In the meantime, even under existing structures, the corporate governance of all four companies is clearly inadequate and in the view of the Review requires early resolution. This is addressed in Section 3.

26. In the case of CFR Marfă, the Review considers that the government should go farther. Freight transport is in all countries an arduous, competitive, low-margin business and it is difficult to see why governments wish to participate in it. In Romania, CFR Marfă is competing against private rail freight operators who face none of the restraints of State ownership, and who understandably concentrate on attracting from CFR Marfă those customers for whom rail technology offers greatest competitive advantage. CFR Marfă (and the other private rail operators) also compete for other traffic against a highly decentralized, deregulated and entrepreneurial road freight haulage industry that faces minimal constraints on entry, movement, management or pricing. It is then not surprising that CFR Marfă's own traffic task, average haulage length and average consignment size are falling and thereby eroding the intrinsic cost advantages of railway technology; at the same time tariffs are inevitably pressured by competition, (which is its purpose). In addition, on many rail corridors in Romania the underlying freight flows are relatively low and those traffics that might be won by rail are not readily divisible between multiple rail operators. If CFR Marfă remains as it is, squeezed between the road haulage industry and the private rail freight industry the government will eventually be left with a company that serves only markets that are the least economic to be served by railway, or made so by market dilution.

27. It is understood that the scoping study for privatization of CFR Marfă has been completed and rests with MOT for modification and recommendation to the government. The Review believes that the government should proceed with a preferred approach as soon as possible and allow the company to pursue its fortunes as a private company before it is too late. CFR Marfă remains the biggest rail freight operator in Romania, and in South-East Europe. Freed of the constraints of public ownership it could provide the nucleus of a strong regional rail freight company or alliance that could better compete with the road transport industry.

2.4 Purchase of Transport Services

28. In its role as purchaser of transport services, the government has implemented EU directives by adopting a comprehensive Public Service Contract (PSC) between MOT and CFR Călători. But the government cannot afford to fund the current level of service contained in the PSC, and commercial responses to such a shortfall appear to have been precluded by weak corporate governance. This issue is addressed in Section 3.

29. While supporting the PSC concept, the Review finds that there are a number of deficiencies in the current implementation. First, the PSC specifies the train-kms 'purchased' on all routes but does not show the individual payment for providing services on that route, nor the number of passengers (or more accurately passenger-kms) that are expected to use the services and on whose behalf the contract is presumably made. Both those figures are known and would indicate the implicit subsidy/ passenger-km and so facilitate more discriminating decisions by Government about which services to support through train services and which might better be supported by bus contracts.

30. Second, the PSC only defines output targets. It contains no input performance targets such as rolling stock utilization (passenger-kms/car) or labour productivity (passenger-kms/employee) both of which have seriously deteriorated in the last ten years. Since CFR Călători's own PSC is currently not contestable (i.e. only CFR Călători is permitted to negotiate for its contract[1]) the incentive for management to seek efficiency improvements is the rather perverse one of underpaying the agreed contract price (due to budget constraints) rather than through an agreed series of efficiency targets.

31. Third, the government pays the fares of a remarkably wide range of user groups, and it also regulates all fares, on all services. Management therefore has no ability to implement more rational and commercial pricing systems. Indeed, as the PSC basically pays the difference between revenue and cost, the contract provides little incentive to collect all the fares it does charge (fare evasion is thought to be substantial). MOT should design and present to Government an alternative fare concession and regulatory policy that gives CFR Călători more commercial flexibility, providing a more limited range of concessionary passenger classes and fewer regulated ticket classes.

32. It is the responsibility of MOT to obtain best value for money for the contracts that it lets for public services, but without any contestability or benchmarking of alternatives there can be no assurance that value for money is attained. Greater contestability for PSC's is a policy option. For example, CFR Călători might continue to run the strategic intercity network, but with the concessioning out of the shorter-distance regional rail services. This could be piloted by creating a separable regional rail company; drawing up the required PSC for that company but without specifying the payment; concessioning the operation of the company with its PSC contract through a bidding process; and monitoring performance and payments. The Review believes that the government should test this option on an experimental basis in a region to establish the best process and with a view to attaining equivalent or improved service at lower cost.

33. A second option that will almost certainly improve the value for public money of social transport services on many smaller branch-lines would be to allow private bus and coach

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[1] Though perversely, other passenger rail companies can compete with CFR Călători on routes supported by public funds, and can receive the same subsidy per train-kms, again independent of passenger use.

companies to bid for the PSC service performance specification on that route. The financial and environmental costs of keeping lightly-loaded diesel trains running on poorly utilized branch-lines is usually so high that, when a fair costing is undertaken, a good quality bus service is able to operate a faster, more frequent service for a lower cost to the taxpayer, and at lower emission levels per passenger. The Review recommends that the government also test this option on an experimental basis on a number of low-density branch-lines with the objective of providing equivalent or improved service to passengers at lower cost. Branch-lines could be mothballed until such trials are proven and any useable rolling stock and infrastructure assets allocated to other parts of the network where they are urgently needed.

2.5 Sector Regulation

34. The fourth role of government in transport sector governance is to administer (or delegate administration of) regulatory systems required to support its transport strategy and policies. There are three main types of regulation: economic regulation; safety regulation; and environmental regulation. Economic regulations may include conditions of licensing of industry entry, service standards, access to infrastructure, price regulations, among others. Safety regulation typically encompasses the standards and oversight of passenger, employee and community safety affected by transport routes, including compliance and investigation mechanisms. Environmental regulation typically encompasses environmental standards such as transport noise and emission standards, together with compliance and investigation mechanisms. In all cases, EU directives and regulations heavily influence the scope and nature of regulations adopted, as do other international agreements particularly applying to international shipping and aviation.

35. The modal directorates of the MOT participate in the development of regulations relating to EU policies and legislation. These include safety, railway interoperability, intelligent transport systems, logistics, road traffic safety audits, and intermodal development and their application in Romania. The *Directorates* also negotiate bilateral transport agreements with non-EU countries.

36. Most other regulatory functions are carried out by off-budget authorities subordinated to the MOT. The costs of regulation are largely covered by licensing and inspection fees, which are imposed upon operators and vehicle owners. The regulatory entities help draft national legislation and to issue rules and regulations and to monitor their enforcement.

37. In Aviation the regulatory authority rests with Autoritatea Aeronautica Civila Romana (AACR). The task of AACR is to issue detailed aviation regulations to complement the international regulations, and to approve licenses and certificates for pilots and aircrafts, and to examine aircraft airworthiness and services relating to air navigation and use of the airspace. Passenger and cargo safety are also within the purview of the aviation regulator.

38. In maritime transport the regulatory authority rests with Autoritatea Naval Romana (ANR). Its activities include ship safety, ship and port security and, in collaboration with other authorities, protection of the marine environment. By surveys and inspections ANR makes sure that ships operating in the Black Sea, the Danube and at the Romanian ports meet all relevant EU and international safety requirements. Minimum safe manning of ships, certificates of competency for seafarers and register of ships and register of seafarers are also the responsibility of ANR.

39. In the railway sector part of the regulatory function is carried out by AFER (Autoritatea Feroviara Romana). It grants safety certificates for railway operators and the railway system, and permits to the railway equipment. The railways have a very extensive set of regulations concerning track maintenance, switches, safety of mechanical devices, rolling stock, markings, signs, and operability of railways. These functions are carried out by AFER. There are European-wide regulations and interoperability systems—such as European Railway Traffic Management System (ERMTS)—which are gradually taken into use.

40. In the Road sector there are two off-budget entities Autoritatea Rutiera Romana (ARR) and Registrul Auto Roman (RAR). They, like AFER, are subordinated to the MOT. ARR and RAR cover their cost through license and inspection fees.

41. Regulatory arrangements must be designed to suit a government's favored transport strategy and policies but there are some basic requirements of any regulatory system: its regulators should be at arm's length from the specific organization that they are regulating; their deliberations should be open and transparent; they should be accountable for their decisions; and the principles they apply should be known and consistently applied. The Review has not investigated the efficiency and effectiveness of the individual regulatory agencies in Romania's transport sector against these criteria. But at a strategic level, it is observed that some of the bodies appear to be responsible for regulatory policy issues that would better reside with the strategy and policy organs of MOT, thereby distancing the referees from the body that makes the rules. It is also argued in Section 2.6 that the distance of the referees from the players, the specific entities that they regulate, could perhaps also be enhanced by grouping the safety regulatory agencies into a single, more powerful and perhaps more autonomous transport licensing and safety agency.

42. Within the railway sector, a specific deficiency in regulatory structure that emerged is the need for an independent body to regulate issues arising out of allocation of railway infrastructure capacity and the access charges levied for use of the railway system. At present AFER licenses train operating companies, CFR SA allocates track capacity and the government (under advice from MOT) sets Infrastructure Access Charges. These divisions are reasonable. But complaints and disputes in these functions are most likely to emerge from private train operators. Such disputes are currently adjudicated by a Railways Supervisory Committee comprised of officers of the MOT, which is clearly conflicted in this role by both its ownership of the two train operating companies which use most of the available train paths and by its role in establishing the charges for use of those paths. There are plans to relocate this function to another ministry and the Review supports such relocation.

43. In the regulatory area it is recommended that:

- an effective railway regulatory function reviewing the implementation of and disputes concerning the application of track access rights and charges be established in another ministry;
- MOT establish a task force to determine the matters of regulatory strategy and policy that should be the responsibility of the policy directorates of MOT; and
- MOT consider establishing a multi-modal Transport Licensing and Safety Agency, which also would take over the driver licensing and driving school oversight; comprehensive management of transportation regulation with a comprehensive public

reporting mandate should improve probity, integrity and transparency of transport sector regulation.

2.6 Administrative Apparatus: Organizing the MOT

44. The Review found that the MOT's apparatus for administering this important sector is modally and functionally fragmented into numerous directorates and is tactical and reactive in its approach. The Review also found that the balance of influences that must necessarily mould the MOT's deliberations and conduct—the political and the technical—seems to be disproportionately skewed to the former.

45. The current organization of the MOT partly reflects principles of functional separation between policy setting, regulation, and infrastructure and transport service provision. However, the separation is not observed in practice and this is exacerbated by the fact that the Minister and other political appointees dominate almost all decision making power—spanning sometimes to very low levels of decision making. The role of career technical and administrative specialists in giving impartial advice or presenting alternative policy options for implementing government strategy seems to be at best consultative; they are mostly used to endorse decisions. This is also seen in the very weak prerogatives of the MOT's Secretary General—the highest ranking technocrat—whose role seems to be confined to coordination of the legislative tasks within the Ministry and with other government departments.

46. Functional gaps and overlaps also exist in the current organization. Functional gaps consist of key roles that are not carried out as they should be such as transport strategy and corresponding policy development, program evaluation and monitoring, or effective stewardship of MOT's shareholdings in commercial companies. These gaps exist partly because of the very fragmented administrative structure of MOT which, on the one hand makes it difficult to pursue complex policies that require multiple inputs and, on the other hand, makes it easy for difficult issues to fall between the cracks. There also is significant functional overlap among the MOT's existing structures leading to uncoordinated action—in the absence of effective mechanisms to work across 'silos' and structures and to share information. The Review noted many overlaps in the MOT's work on European legislation for example, and in important tasks such as the numerous institutional studies carried out in the past, or the general master plan. There are even more serious overlaps between the MOT structures and the infrastructure or service companies, as illustrated by multitudes of reviews and layers of approvals in the MOT for matters that have already gone through similar procedures in the provider entities. Finally, there are functions currently exercised by the MOT that would normally be considered outside the scope of the transport sector. For example, the Ministry has a general directorate for medical and social assistance, and there are 15 hospitals reporting to it.

47. The Review considers that the government should restructure the administrative apparatus of the MOT to fulfill its roles more effectively: delineate the roles and responsibilities of political appointees vis-à-vis those of public servants in a way that will empower the latter to give impartial advice to the former; reduce functional gaps, and overlaps; strengthen MOT's capacity to create long-term multi-modal and integrated transport strategy, develop and implement policies and financing to implement such strategy, evaluate the performance of such programs, and regulating the transport industry; implement principles of good corporate governance in and stewardship over the entities reporting to the MOT; but preserve the existing

mechanisms already in place to manage EU-funded programs. Structural change in the MOT would need to be carried out in tandem with changes in *Human Resource Management* in line with broader recommendations for the Romanian public administration made elsewhere by the wider Functional Review.

48. The number of (formal) political appointees—now estimated to be 20—should be reduced to the minimum necessary to properly support the Minister's duties. The number of State Secretaries in MOT should be one with specific responsibilities for the challenging parts of the portfolio, including parliamentary relations. Current administrative and technical responsibilities of State Secretaries should be delegated to career technocrats such as General Directors, and, especially, at the MOT, to the General Secretary whose responsibilities for this position need to be revised.

49. The MOT continues to administer a number of medical and health facilities and services which has little to do with promoting the public interest in the transport sector and for which its administrative expertise appears limited. There are of course areas of occupational health and safety that are important to the state-owned transport companies but should be the responsibility of those specific companies (either through in-house or contracted out service provision). Otherwise, the Review recommends that MOT's administration of medical services and hospitals be transferred to the responsibility of Romania's Ministry responsible for health or to other relevant bodies.

50. The Review suggests that the government consider reorganization of the MOT into five General Directorates, with the following remit, each led by a qualified and experienced public servant. More details are provided in Annex 2.

- **Transport Strategy and Policy** (covering all modes): This would allow the consolidation of the multi-modal strategy and policy functions which are the core business of the MOT. Under this arrangement, the MOT's current "normative" compliance verification functions would be reduced and kept at the level of the sub-sector entities such as RNCMNR or CFR SA. As detailed in the Annex to this Report, this Directorate will have important functions—organized in subunits—including: transport strategic planning, safety and environment policy, private sector participation policy, and development of service specifications (PSCs, Performance Agreement with RNCMNR, etc.)

- **Budget, Finance, and Management:** The key change compared to the existing structure is the addition of the management and program evaluation functions to the existing budget and finance directorate. Therefore, the Directorate would not only oversee the preparation of the transport sector's budget and supervise its administration in the MOT and in the reporting agencies, it would additionally: ensure the evaluation of the effectiveness of sector programs, policies, and procedures, assess competing funding demands among agencies, set funding priorities based on the strategy and policies, and ensures that agency reports, rules, and proposed legislation are consistent with the budget and with the sector policies. It is also possible that these management and program evaluation functions be undertaken under the proposed Transport Strategy and Policy unit.

- **European and International programs:** It is not proposed to make any significant change to the existing directorate, which has a key role in fulfilling the Ministry's function as managing authority for EU funds and coordination and monitoring of externally financed programs. It is however proposed that substantive policy or strategy aspects that are supported by such externally-financed programs be coordinated or managed by the strategy and policy directorate. This would include for example technical assistance that deals with strategic aspects such as planning, road user charges, etc.

- **Management of the Shareholdings:** In order to rectify the very weak corporate governance in the many state-owned enterprises (SOEs) reporting to MOT, it is important that the MOT put in place this directorate to oversees the fulfillment of state ownership objectives in these SOEs. Many European and OECD countries have a national body or agency with such a mandate. However, in the absence of a similar mechanism in Romania, the Review strongly recommends that such a directorate be set up initially within the MOT. The key objective of such a directorate would be to ensure that sector policy objectives are achieved in the most efficient way possible; that the companies are run in a commercial, business-like, and transparent manner; and that adequate corporate governance and professional management are in place to deliver value for money for Romania. To do so, the directorate would formulate a clear ownership policy; publish regular reports on the companies owned by the State, their operations and their results; monitor and benchmark the performance of the companies; develop, implement and report on the structure for the process relating to the appointment of company board directors; etc. The Annex to this Report provides more details.
- **Administration Services** (Human Resource Management, Legal Affairs, Procurement, Property Management etc.): These are administrative services that will need to be consolidated in one single directorate.

2.7 Summary of Recommendations on Sector Governance

51. In summary, the Review recommends that Government, through MOT or other channels, take the following actions to improve the governance of Romania's Transport Sector.

- Prepare and publish a realistic policy-oriented, medium-term national transport strategy, which is robust with regard to a range of likely resource levels, in a form compatible with good practices adopted by other Ministries of Transport in the EU.
- Consider reconstituting CFR SA and RNCMNR as infrastructure delivery, management and maintenance companies, with the function of asset ownership and determination of strategic directions and main priorities of the rail and road networks themselves falling directly to (and appearing within the accounts of) the State. The Review does not recommend splitting RNCMNR into two agencies (one for operations and maintenance and the other for capital investments).
- Privatize CFR Marfă as soon as possible in a way that will allow it the opportunity to successfully compete on equal terms in the freight transport industry.
- Adopt an alternative fare concession and regulatory policy that gives CFR Călători much more commercial flexibility while providing social fare options for poorer travelers.

- Publish average subsidy/passenger on all passenger rail services (public and private) and work with CFR Călători to negotiate an Affordable multi-year PSC, with built-in efficiency incentives.
- On a trial basis, create a separable regional passenger railway company from CFR Călători's regional (non inter-city) operations and award the PCR contract of that company by competitive tender to properly qualified and licensed private railway companies, with a view to attaining equivalent or improved service at lower cost.
- On a trial basis, draw up PSCs for social transport services on a number of branch-lines, and let the contracts by competitive tender to properly qualified private bus service operators, with a view to attaining equivalent or improved service at lower cost.
- Establish in another ministry an effective railway regulatory function to oversee the implementation of and disputes concerning the application of track access rights and charges.
- Establish an annually reviewed Performance Agreement with RNCMNR with multi-annual perspective and budget envelope.
- Determine the matters of regulatory strategy and policy that should be the responsibility of the policy directorates of MOT.
- Consider establishing a multi-modal Transport Licensing and Safety Agency, which also would take over the driver licensing and driving school oversight; comprehensive management of transportation regulation with a strengthened public reporting mandate should improve probity, integrity and transparency of transport sector regulation.
- Reorganize the MOT into more substantial and multi-modal General Directorates that will help reduce gaps and overlaps in functions.
- Transfer the functions of medical and social assistance and the hospitals to the ministry responsible for health.

3 Corporate Governance

3.1 Introduction

52. This Section addresses corporate governance issues related to the four companies CFR Marfă, CFR Călători, CFR SA and RNCMNR.

53. The adoption of a company structure for the main transport sector delivery agencies put Romania many years ahead of its time in the transition to a market economy. Use of Company Law to reconstitute the delivery agencies was supposed to be a tool to facilitate 'arms length' distance for the delivery entities from both the in-built structural bureaucracy of government departments and the influence of short-term political decision-making.

54. However, the corporate form for state-owned enterprises is a means to an end, not an end in itself. The architecture of a wholly state-owned company needs some heavy reinforcement if it is to effectively create the degree of autonomy on which its success depends. This section deals with some of the reinforcements that were omitted from the architecture at its inception, and not rectified since. These omissions have meant that the transport companies have not migrated to become autonomous enterprises responsive to their markets, but are effectively branches of MOT reincarnated in a corporate form.

55. All of the companies have faced significant challenges in their areas of responsibility, but have failed to respond appropriately. In the case of CFR Călători, for example, over the ten years 2000 to 2009, the number of passenger-kms carried roughly halved but the number of passenger train-kms operated in 2009 were only 4 percent less than in 2000. As a result the average number of passengers/ train reduced from around 170 to just over 90. Despite some reduction in average train size, the average number of passengers/railcar fell by nearly a third. And despite significant staff downsizing, staff productivity in terms of passenger-kms/employee fell by at least a quarter.

56. CFR Marfă was more focused in trying to match its train service to a rail market declining due to a restructuring of the economy, competition from road transport, and competition from private freight train operating companies; it managed to improve average train-load marginally over the period. But while it adjusted train operations, it retained far more staff and assets than justified by those train services so that labor productivity, quite high in the year 2000 compared to European norms, had halved by 2009, as had locomotive and wagon productivity.

57. In the case of CFR SA, which serves CFR Călători, CFR Marfă, and private freight train operators, the average standard of infrastructure has fallen more or less continuously on all key performance indicators. The quality and reliability of freight train paths through the system was cited by a number of freight train operating companies as having become a serious constraint on competition with road transport.

58. The situation of RNCMNR is not very different, though the challenge in the roads sector was the opposite one to railways, and was rapidly increasing demand. Road infrastructure was neglected under the policies of a planned economy, and it was anticipated that the rapid increase in road transport demand due to the restructuring of the Romanian economy would require an improved road network maintained to higher standards. But even though priority has been given to capital funding of roads over railways, and with significant budgetary resources in the past

decade, RNCMNR has been unable to deliver a much needed program of capital investments in motorways and roads on time and within budget, and it has been unable to improve the efficiency of its road construction and maintenance functions.

59. An adjustment of modal balance from railways to a newly liberated road transport and private car sector was both predictable and a widely predicted consequence of economic restructuring. The real failure has been the inadequate response of all four companies to the new market conditions. When a company has short-term failures it can be put down to many causes: sudden market changes, poor individual management decisions, trade union actions and so on. But when such serious flaws in a company's strategy and performance endure over many years, the principles that underpin a joint-stock company mean that responsibility lies clearly with its Board of Directors and Shareholders. The Board of Directors' role in a joint-stock company is to establish and monitor the company's direction and strategy; the Shareholders' role it is to select the Board of Directors.

60. In this case it is a systemic failure of Corporate Governance (rather than personal failures of individuals). The same 'generic' group of Directors and Shareholders have directed and monitored all four companies, on behalf of the State, for the last twelve years. A combination of Board domination by MOT—sometimes with strong political backing—the concentration of the administration of the Shareholding in MOT, the reserved rights of the MOT-dominated Assembly of Shareholders, and the MOT selection of the Chairperson and CEO has effectively closed, or rather never allowed to open, the 'arm's length' distance between MOT and the companies that their corporate form was intended to create.

3.2 Board Composition

61. The membership of the four companies' Boards is selected by the MOT. The Chairperson (who is also CEO of the Company) is appointed by the MOT, as are 8 of the other 10 Directors (in the case of railways). The nominees of MOT are normally officers of MOT, but they are sometimes with strong political backing. The two external Directors are delegates of the Ministry of Public Finance and Ministry of Labor.

62. A Board of Directors is expected to fulfill several roles in a company: to establish the company's vision, goals and values; to determine strategy and high-level structure; to ensure management of the necessary caliber is employed; to delegate day-to-day decision-making to that management; and to monitor management performance. It is not at all clear how a Board of only career public servants can furnish a Board with the diversity of professional skills and experience necessary to fulfill these onerous roles in what are some of Romania's largest and most important companies.

63. Moreover, a Board Director is expected to exercise independent judgment in discharging her/his basic responsibility to shareholders. MOT employees act as delegates of MOT often deciding issues in pre-meetings of MOT; inevitably they will on the whole be motivated more by the political interests of their Minister, and/or to the bureaucratic interests of their Ministry, than to the long-term interests of the companies to whose Boards they are appointed.

3.3 Shareholdings and Reserved Shareholder Rights

64. The shareholdings of the companies are owned by the State but the State's shareholder rights and responsibilities are wholly delegated to the MOT. In turn, the MOT delegates its shareholders rights to an Assembly of Shareholders.

65. Under the founding ordinances—and unlike in most joint-stock companies—despite a Board that is already MOT-dominated, the shareholders have been given a short-term veto over many of the substantive decisions of the Companies' Boards of Directors. Most Directors' Meetings are followed by Extraordinary Meetings of the Assembly of Shareholders to ratify (or reject) Board decisions. The Assembly consists of 4 delegates of MOT and 1 delegate from Ministry of Public Finance invited by MOT.

66. Therefore even if the Board of Directors were to exercise independence of decision-making, decisions can be rescinded within hours by instruction of a Minister to the Assembly of Shareholders where his delegates also dominate.

3.4 Selection of CEO and Chairperson of the Board

67. As noted, the Minister of Transport also appoints the CEO of each of the four companies and the CEO becomes Chairperson of the Board. The Board has no rights of nomination, selection or veto over the appointment. Indeed, it is difficult to envisage that a Board employed by the Minister of Transport would give explicit voice in the Board to doubts on the suitability of the Minister's choice.

3.5 Business or Corporate Plan

68. All four companies have an annual budget, and some have long-term investment and other plans. But the Review is not aware of any obligation of any of the companies, either in its foundation documents or under instruction of its Board, to produce a regularly-updated, medium-term Business or Corporate Plan which in most companies is one of the key documents by which the Board exercises its responsibilities of strategic review, guidance and monitoring.

3.6 Transparency and Disclosure of Information

69. The Review noted that the MOT does not have a clear disclosure policy or standard ownership report concerning the SOEs in its portfolio. Information—when available—is scattered. It is therefore important that MOT develop such a disclosure policy and prepare annual reports on the activities of all SOEs in its portfolio. The recommendation made by the Review to create a new unit in the MOT to deal with "the Stewardship of State Ownership" should enable the MOT to have a structure in place to cover these important aspects of transparency, disclosure, and more importantly stewardship of public assets.

70. Additionally, at the SOE level, annual reporting and disclosure of information are weak, and when they exist, cover mainly achievements in terms of physical outputs and discussion on budget implementation. In fact, in terms of Board reporting, the statutes of the companies stipulate that the Board should submit an annual report on the activity of the entity, the balance sheet and the profit and loss account to the General Assembly of Shareholders. However, there are no specific MOT guidelines concerning the content of the report and the distribution to

various stakeholders, including the general public as the ultimate shareholder of these entities. The SOE should produce and disclose to the public annual reports.

71. Finally, there does not seem to be a requirement for annual independent external audit based on international standards. In the case of RNCMNR and CFR SA, such audit reports have been prepared in the past at the request of IFIs, and when they were prepared there is no evidence to suggest that they were ever made public, nor were the auditors' recommendations implemented. Therefore the Review recommends that the SOEs should be subjected to annual independent external audit based on international standards, and that the audited financial statements be attached to the annual reports and made public, including through company websites.

3.7 Subsidiary Companies

72. A final corporate governance issue which the Review found to be problematic is the existence within the corporate structure of each of the railway companies of a number of subsidiary companies: CFR SA owns 7 such companies; CFR Marfă and CFR Călători each owns five. Together, these 17 companies employ around 14,000 people, more than the total numbers of people employed on some smaller EU railway systems such as in Belgium, Sweden or Finland. The Review believes there can be good reasons for establishing subsidiaries, such as to create a structure to enable the parent company to foster competition with external suppliers, and/or to free the subsidiary to develop additional external markets of their own, or as a precursor of divestment of non-core business to another owner.

73. Such reasoning is not evident in most of these cases. Among the subsidiary companies that have been formed by each of the three main rail companies there is a mixture of those performing core and non-core functions, but in nearly all cases the subsidiary companies neither compete with private companies for the contracts that they receive from the parent, nor do they earn any significant income from contracts independently won from other companies. Nor are there any plans to divest them, which is understandable in some cases given the core functions that they perform. Given the timing of their set-up it is difficult to avoid the inference that their main purpose at the time was to transfer employees out of the main businesses to meet externally-imposed employment targets.

74. In railways, as in other industries, the decision as to which support industries to retain in-house and which to outsource should be based on a considered business justification of each compared with the alternative of contracting out. This will differ from railway to railway, and service to service. Some service activities arguably embody core skills or competences which if divested entirely to outside contractors may increase critical risks, or reduce the organization's ability to assess or control those risks. For others, the external market may be too thin or poorly developed to make competitive out-sourcing an attractive prospect. But as many railways have found, most non-core services can be reliably outsourced, often improving the quality of service and almost always providing a long-term saving of cost that can turned to competitive advantage in the core transport activity.

75. The Review recommends that the Boards of the three main railway companies commission an independent business review of the subsidiaries, with a view to divesting those companies that do not provide core services and whose services can be competitively procured, and transferring directly back under the executive control of the parent company those core

functions for which no competitive procurement is possible and no rationale for separate corporate existence can be made.

3.8 Summary of Recommendations on Corporate Governance

76. Based on the above, the Review recommends that the government take the following actions to improve the Corporate Governance of the four companies.

- Delegate stewardship of a majority of the companies' shares held by the Romanian State to another ministry, removed from the day-to-day political consequences of the decisions made by Boards in the interests of the companies: also change the balance of the Assembly of Shareholders accordingly.
- Manage the MOT's shareholdings in the companies through a new specialist Directorate in the MOT with a mandate confined to good long-term stewardship of public shareholdings (See section 2).
- Restrict the number of matters on which the Assembly of Shareholders has final endorsement or veto over Board Decisions; apart from exceptional Special Resolutions it should not be necessary for Shareholders to meet more than twice annually.
- Create smaller, more independent and more professional Boards by limiting the number of Board Members to a maximum of eight persons, seeking nominations in proportion to the revised shareholdings, requiring a majority of Board Members to be independent of the shareholding ministries, establishing selection criteria requiring relevant professional skills and experience, and remunerating the independent directors at rates necessary to attract suitable candidates.
- Separate the roles of CEO and Chairperson of the Board, the latter to be a part-time position.
- Require that CEOs be selected by a merit-based process; empower the Board of Directors to solicit applications and interview candidates for the post of CEO and to recommend such candidate or candidates for ministerial choice or approval; introduce minimum fixed-term management contracts for CEOs.
- Require the Companies to present annually to the shareholding ministries the Company's medium-term Business or Corporate Plan, prepared by Management and provisionally adopted by the Board, and to take account of the shareholding ministries' written comments in the finalization and adoption of such a Plan.
- Raise the minimum requirements on annual reporting and disclosure of information, and mandate annual external independent audit in accordance with international accounting standards.
- Require the Boards of the three main railway companies to commission an independent business review of their subsidiaries to determine the optimum strategy for their future form.

4 Corporate Management and Processes

4.1 CFR Marfã

77. In Section 2 the Review recommends that the government should privatize CFR Marfã as soon as possible to give it the best chance of surviving in the highly competitive world of freight transport. In 2008 the company made a loss of RON 183 million which in 2009 increased to RON 361 million.

78. The company cannot reasonably anticipate any strong recovery in its freight revenues in the foreseeable future because of the severity of economic conditions and intense competition from both road hauliers and private rail operators. It can also not be argued that CFR SA should reduce freight train infrastructure access fees. Access fees are only 14 percent (2009) of CFR Marfã's operating expenses (not excessive in terms of typical railway cost structures). CFR SA's finances are also in a critical condition and it cannot afford to grant lower freight train access fees to the public and private rail freight operators (which must legally be treated equally).

79. To return to profitable operation on an annual basis CFR Marfã must achieve radical improvements in its asset utilization and labor productivity to reduce the approximately 80 percent of operating expenses which are within the company's long-term control (excluding access fees and depreciation). In broad terms, profitability can only be restored by reducing its cost base by between a third and a half. Such a change would bring its efficiency to levels comparable with Romania's private freight train operators, but these improvements can only be attained if it moves towards a service model closer to those competitors.

80. In order to do so the company will have to adopt a new and more selective approach to its operations, particularly in its market positioning and service strategy. The company currently operates over more than 90 percent of Romania's railway network. International experience suggests that CFR Marfã's acceptance of sometimes small and infrequent wagon-load consignments for collection and distribution between more than 500 Romanian freight stations (112 of them employing full-time staff) cannot possibly be sustained on an economic basis: this business model makes it harder to increase train sizes, creates high shunting and marshalling costs, holds down rolling stock productivity, and causes low labor productivity both in terminal operations and in clerical areas such as freight accounting.

81. Under private ownership CFR Marfã's rail freight business model would be radically restructured, and is likely to include the following kinds of measures:

- the concentration of human and capital resources on servicing and retaining train-load and semi-trainload freights while trying to increase train size (and net/tare freight ratios) in such operations in so far as it is consistent with meeting market frequency needs;
- the withdrawal or rationalization of services to those consignees of small and irregular wagon-load freight consignments in relatively remote locations who are not willing to pay for the full costs of service so that CFR Marfã will generally migrate to servicing fewer but busier rail freight hubs and stations between which the Company can run more regular and reliable train services;

- early divestment or scrapping of all non-economic assets made redundant by such strategy including buildings, locomotives, wagons (especially wagons with poor net-tare ratios) or other assets;
- the reduction of CFR Marfã's labor force to match the new business model, which is likely to require an increase labor productivity by at least 50 percent (relative to a 2009 benchmark traffic task);
- re-pricing or termination of branch-services or individual traffics that, even under targeted efficiency improvements will not recover at least their avoidable costs of operation (including train crew, fuel/energy, locomotive and wagon maintenance, and variable track access charges): it is likely that at least a quarter of CFR Marfã's traffic will be in this category;
- creation of a management structure that creates profit-centre responsibility for main lines-of-business with individual product managers who would also be encouraged to aggressively win back profitable traffics lost to private rail operators, and target other promising market sectors, using rolling stock freed up by withdrawal from non-profitable markets.

82. CFR Marfã's key managers and operational staff could be instrumental in implementing a new business model that would secure the future of the company, and it is important that government encourages their retention through the process of privatization. If privatization occurs quickly, as recommended, there will not be time to implement a new model but it would be prudent for CFR Marfã's management actively to prepare for privatization and to be ready to present and discuss commercial and operating options.

4.2 CFR Călători

83. In 2008, after receiving subsidies from government of RON 1.34 billion (PSC payments of RON 1.22 billion and rolling stock subsidies of RON 221 million), the Company made a loss of RON 267 million. In 2009, after subsidies of RON 1.44 billion (RON 1.11 billion from PSC payments and RON 326 million rolling stock subsidies), the loss reduced to RON 229 million. Rail system subsidies in Romania are in absolute terms much lower than those in many EU countries[2] but the substantial losses incurred even with support and the deterioration of the cash-flow position indicate that Romania cannot afford to pay for the service specification that the MOT has contracted in the PSC.

84. In a situation in which the company would be at 'arm's length' from its main customer—i.e. MOT—it would be expected that it would now pursue one (or a combination) of three options: try to improve its efficiency and productivity to meet the existing PSC specification and price without incurring losses; cut-back or restructure into profitability any loss-making services that are not specified in the PSC; or decline to agree to meet a PSC specification if MOT's budget is not able to fund it. The Review found that company management is attempting to improve its efficiency, but is either not willing or not empowered by its Board to cut back services to the extent that could possibly rectify the deficiency in PSC payments.

[2] The average railway budgetary support (capital support plus PSC payments) in Romania is just over EUR15/per person in 2008, compared to over EUR100/person in the EU-15.

85. In the longer-term the creation of an independent Board in CFR Călători might create the ‘arm’s length’ distance from MOT that could lead to negotiated resolution of the mismatch between specification and resources, but in the financial difficulties which now exist it is important that the PSC specification is brought rapidly into line with a realistic estimate of the budget resources available in the next 3-5 years.

86. MOT, as the purchaser of rail passenger services, must take the lead in giving CFR Călători a prudent PSC financing envelope and CFR Călători must work iteratively with MOT to develop a PSC specification that it could meet for the price, after allowing for efficiency improvements, within that financial constraint. It should also contain incentives for both efficiency improvements that reduce average cost/railcar-km and commercial incentives to improve revenue earnings/railcar-km. These are the decisive drivers of the economics of rail passenger operations, assuming a constant level of track access charges. The Review refers to such a specification as an Affordable PSC.

87. It is for management and MOT to agree the Affordable PSC, but the necessary measures can be developed from ideas and proposals contained in the “Survey of Market Demand for Railway Passenger Services”, (by Italferr Consultants, September 2008). This Report found that if MOT is willing to modify the PSC accordingly, CFR Călători could reduce its requirement for state support to passenger services by about a quarter.

88. The modifications to railway passenger service would be significant, but the social value of transport services could be maintained by making better use of existing rolling stock assets and replacement of some rail services by more cost efficient bus services. Both the average cost/railcar-km and the average fare yield/railcar-km can be improved by management actions both on the supply side and the demand side. On the supply side, the measures would include:

- Rationalization of the most underutilized lines, especially those in the ‘Personal’ category with seat utilizations of less than 25 percent, and replacement with bus services.
- Sizing of other train consists (numbers of coaches) better to actual demand to reduce fuel and coach maintenance costs.
- Some merger/differentiation between other categories of train services to reduce the current service ‘brands’ from four to three while matching frequency to market.
- De-manning of stations where passenger numbers do not justify it and that add disproportionately to delivery costs relative to revenues.
- Improvement of maintenance and shunting practices without uncoupling of the coaches.
- Reorganization of depots and workshops for light maintenance.
- Reduction of staff numbers to match the modified PSC specification and more efficient business model.

89. On the demand side, the ability and incentives of the company to improve revenue earnings/railcar-km are heavily constrained by the high proportion of concessionary passengers, by the heavily regulated structure of normal fares, and by the construction of the PSC itself. While so many passenger fares are paid by the taxpayer, and virtually all railway fares are fully

regulated by the Ministry of Public Finance, from the poorest passenger on a remote branch to an international businessman on an inter-city express rain, CFR Călători has no realistic scope to use yield-management techniques to try to maximize sale of unused seats and improve average earnings per railcar-km. But even if it had this freedom (recommended in Section 2) the form of the PSC gives limited incentive to do so or even to collect all the fares it does charge. The Affordable PSC should be redesigned contain both efficiency and revenue collection incentives.

4.3 CFR SA

90. In 2008 the Company made a loss of RON 892 million after income from Track Access charges of RON 1,018 million and receiving from government contribution to infrastructure of RON 96 million. In 2009 the company's loss increased to RON 1.215 billion, after income from Track Access Charges fell to RON 938 million and government contribution to infrastructure fell to RON 55 million. Leaving aside penalty payments and depreciation its results were consistent with an average expenditure of about EUR 18,000/track-km at 2009 exchange rates. This appears to be a low expenditure for the management, maintenance and traffic control of a mixed passenger and freight network including yards, stations and terminals. But is typical of recent years, so that it is not surprising that the average standard of infrastructure is steadily declining. On some routes, CFR SA is now unable to offer a standard of service to freight and passenger train operating companies that give them much hope of competing against a robustly expanding road freight and passenger transport industry.

91. CFR SA is currently pursuing labor reductions to help increase labor productivity, and should be encouraged rigorously to pursue all other short-term efficiency measures that it can. But labor restructuring measures on any practicable scale cannot possibly fill the gap between income and the funding needs of the Romanian railway network as currently configured and utilized[3]. On the revenue side, train operating companies already pay a significant level of track access charges in about the middle of the European range, and pay a higher proportion of their track costs than the road transport industry. So in addition to efficiency measures, MOT which represents the State in the ownership of the railway network, must provide CFR SA more funds for discharging the management and maintenance responsibilities that have been devolved to it, reduce the extent of the network that it requires CFR SA to manage or maintain, or a bit of both. A fourth option is to allow the network to continue to deteriorate but, given the competitive pressures on the train companies that use it, that is a recipe for ultimate collapse of the rail industry.

92. In a situation in which the company managing the assets would be at 'arm's length' from the owner of the assets (MOT) it would be expected that the Board would present to the MOT the alternative options, containing a mixture of network configurations, efficiency measures, and funding levels, that would bring CFR SA to a long-term sustainable position. To the best of the Review's knowledge, the CFR SA Board has neither requested management to prepare such options and indeed MOT has not required the CFR SA Board to submit such options to it.

93. In the longer-term the creation of an independent Board in CFR SA might create the 'arm's length' distance from MOT that could lead to negotiated resolution of the mismatch

[3] This is not surprising as there are very few mixed passenger and freight railways in the world in which freight and passenger train users recover the full costs of infrastructure and these are railways like China and India which have traffic densities many times higher than those of Romania

between specification and resources, but in the financial difficulties which now exist it is important that Romania's strategy for the rail network is brought rapidly into line with a realistic estimate of the budget resources available over the next few years.

94. MOT, as the owners, must take the lead in setting up a Working Group with the CFR SA to develop and evaluate alternative options to attain a sustainable rail network capable of competing with road transport in the corridors where rail can realistically compete in the long-term. The Working Group should invite representatives of public and private train operating companies, the users of the network, to contribute to its deliberations.

4.4 RNCMNR

95. RNCMNR has a mandate to develop—for approval by the MOT—the road network development and modernization strategy, and integrated development plans and programs. RNCMNR also has the mandate to maintain and manage national roads. In practice, RNCMNR lacks the management structures and processes to deliver on its mandates.

96. The documented long to medium term planning is confined to programs funded from EU structural funds. There is a long term program to upgrade 8,000 km of national roads to meet EU axle load standards and another program to build several important bypasses, but these programs are experiencing severe implementation delays.

4.4.1 RNCMNR mission

97. As indicated in Section 2 of this report, transport and road sector policies and priorities are not clear, and this translates into a lack of direction for RNCMNR. RNCMNR does not have a clear vision nor mission statement. There is no written description of the problems and issues RNCMNR has or faces, and its mission and strategic directions to address these problems and issues in operational terms are not defined or disclosed. RNCMNR publishes annual reports that describe its accomplishments in terms of use of budgetary funds, but with the lack of clear prior objectives, these reports cannot be used to monitor corporate performance. Guidance on these issues is provided in Annex 7.

4.4.2 RNCMNR organization

98. The Review considers that RNCMNR is too heavily capital project-oriented. To fulfill its mandate the Technical Department of RNCMNR must be strengthened, and project preparation and management processes streamlined from advance planning to implementation, including coordination with budgeting. Guidance on organization matters is provided in Annexes; however, there is little point in restructuring before the RNCMNR mission, freedom to manage and other matters are resolved.

99. The capital investment function in RNCMNR is additionally split between two departments: projects funded by the state budget, and projects funded by loans and credits from international financial institutions (IFI). The latter department benefits from complete support structures covering procurement, financial management, among others—this was supported and approved by the EC and IFIs. This leaves projects funded from the budget with a lower level of oversight when it comes to the support functions at a time when these projects include one of the largest motorway projects in Europe, the Transylvania motorway. The division between the two

departments is not functional: both parts of the organization are served with several directorates, departments and service offices. The Review recommends that the EU-IFI department absorbs the state-funded projects directorate and that the duplicate support functions be dismantled. Additionally the Review does not see the need for the two director level positions (for motorways) reporting directly to the General Manager.

100. RNCMNR has seven Regional Offices with unclear responsibilities—although they mainly carry out road maintenance activities. The Review finds that the regional offices are overstaffed with unskilled labor, that undertakes routine maintenance activities—when and if there is budget for materials and maintenance equipment. The Review recommends that the regional offices should be involved in the implementation of capital investment projects, they have better technical skills than in headquarters, and they are closer to the site and to local authorities and citizens. Maintenance activities should be outsourced and the regional offices should take on the management of those outsourced maintenance contracts.

101. By tradition and rule-based (rather than condition-based) maintenance practice, the Regional Offices submit project proposals to the main office, but the final program authorized by MOT may or may not consider these proposals. RNCMNR has a road management system for pavements, but it is not used to determine priorities. Because the received RNCMNR budget has typically been less than 20 percent of the budget RNCMNR has requested through MOT, both project selection and trade-off between maintenance and capital projects is arbitrary. Despite the much lower budget received, numerous reasons contribute to lengthy delays and cost overruns of projects.

4.4.3 Road functional classification

102. Functional classification is the basis for road management in most EU countries. Romania follows that practice in principle and the national roads are classified functionally as motorways and E-roads, main roads, and secondary roads. However, except for motorways, the design and maintenance standards are not consistent and specified by functional class and traffic volume. The standards seem to be tied to whichever (foreign) consultant designs the section. RNCMNR’s road maintenance is in principle rule-based—e.g. specified actions are to be carried out at certain time intervals—rather than based on road condition and traffic volume, which is the modern practice. In practice, funding constraints do not allow the maintenance rules to be followed anyway. Roads are maintained by tradition within the available resources. RNCMNR roads have a high cost relative to international benchmarks, road traffic safety remains low although improving, and political factors strongly influence the allocation of funding.

103. RNCMNR’s experience with road management does not follow modern practices, under which road management is an economically-driven activity, with sufficient maintenance to preserve assets being the first priority, and capital investments justified by their economic returns. Guidance on road maintenance to allow for a more efficient asset management policy is provided in Annex 9. It is worth mentioning that a proposal for modern maintenance standards was embedded in a pilot performance-based maintenance project in Craiova, which was developed in 2008/2009 but was never implemented. The adoption of condition-based maintenance standards and an overall road functional classification should be undertaken. Additionally, given the importance of road maintenance to road user costs and level of service, RNCMNR should institute annual surveys, summer and winter, of road user satisfaction with the

quality of road maintenance, which can be useful to complement data from the road management system for condition-based maintenance.

4.4.4 Resource planning

104. The road sector budget and its structure are important for tracking road sector strategies and policies. The road budget provides the framework for assessing their effectiveness, for structuring and monitoring all road management costs.

105. The current RNCMNR budget chapters allow discretion of purposes for which public funds are spent (e.g. repairs and investments) and the sources of funds (e.g. operating revenues, IFI loans, etc.). This structure is not useful for making decisions on key policies or for monitoring effectiveness of activities, or even particular activities such as road traffic safety.

106. There is tight ministerial control of project approvals and payments to contractors and consultants.[4] Ministerial discretion in approving projects makes program evaluation difficult, because MOT has firm control over the road company. For example, for payment of road projects the road company must present invoices monthly to MOT. But, budget funds are released quarterly, normally in the fourth quarter of each year.

107. Thus, RNCMNR does not function as a company, but MOT verifies, and approves all expenditures. Political control begins at budget preparation cycle:

- In May of each year MOT submits to the MPF its budget needs by project, including estimates of counterpart funds. In August it receives the budget ceiling and budget estimate for the next three years. In 2010 RNCMNR received a fraction of what it requested.
- In September/October the MOT prepares a detailed program that is at or below the budget ceiling, along the following priorities: (1) co-financing of European funds, (2) co-financing of existing loans, (3) ongoing projects, and finally (4) new projects. These prioritization criteria can change since decisions can be made at the discretion of the Minister and State Secretaries.
- In November the draft budget law needs to be approved by Government and the draft law is submitted to Parliament.

108. The Sector Operational Program for Transport (SOPT) for 2007-2013 has experienced serious delays due to delays in project preparation, inadequate engineering design, complaints on procurement and a host of other reasons. This problem is not confined to the roads sector.[5] Only about Euro 40 million was spent by 2009, more than Euro 1 billion less than planned, and delays continue through 2010. Similar delays are experienced in IFI funded projects.

[4] Projects of less than RON 4 million are approved by ‘ministerial agreement in principle’, projects less than RON 25 million require the Minister’s decision after several layers of bureaucracy have approved ‘economic indicators’. Projects of more than RON 25 million require a Government decision.

[5] While outside the immediate scope of the Functional Review of the Transport Sector, it appears that Romanian public procurement regulations or the way in which they are applied have led to a high level of contestation of contract awards and disruption of project implementation timetables than is usual in most EU countries.

4.4.5 Oversight and Monitoring

109. For road plans and programs to be useful and used they need to be consistent with the RNCMNR mission and strategic directions, and with the budget available. Only then is monitoring of the road program meaningful. A useful mechanism for monitoring and evaluating RNCMNR accomplishments is a Performance Agreement between MOT and RNCMNR. It should be prepared annually after guidance on the budget and changes in policies or emphases on the previous ones. The results should be presented in the RNCMNR Annual Report. (For guidance on Performance Agreement and Annual Reporting see Annexes 7 and 8).

110. There is a 'Sustainable Transport Strategy for 2007-2013, 2020, 2030' prepared by the MOT Directorate for Management, Strategy and Environment, and approved by Government in March 2008, and an 'Integrated Strategic Plan for the Transport Sector', approved in June 2009. However, the Review found little evidence that these documents are used to guide strategy in the sector, and the MOT unit does not evaluate implementation or usefulness of the strategies. The Annual Sector Program merely provides a list of projects and funding sources. RNCMNR has made its own strategy consisting of a list of capital investment projects.

111. For short-term planning and monitoring the MOT Directorate for Management, Strategy and Environment prepares a Quarterly Report that details completed activities of the Annual Programs. Both reports are submitted to the road (and rail) companies—but apparently are not used. RNCMNR has no formal monitoring of its accomplishments against objectives or targets, with the exception of the annual activity report which describes the status of project implementation and their costs.

112. Thus, some basic components for monitoring the road programs do exist but they are weak, and more importantly, they are not used because they are perceived to lack real meaning. Monitoring is made difficult because of the fluidity of the budget, and the degree of discretion of the Minister and State Secretaries.

113. It is recommended that each year RNCMNR management should present for adoption by its Board an updated medium-term Corporate (or Business) Plan, as would be expected by the Board and Shareholders of any major public company. For clarification, the Performance Agreement is effectively the 'Contract' between the Client (MOT) and the Company and it sets out what the Client is going to pay and what 'outputs' it expects in return. A Company's Corporate (or Business) Plan sets out how the Company will conduct its business to meet its objective (in the case of RNCMNR the delivery of the agreed performance) and what results it expects (operational and financial targets). The Corporate Plan will therefore set out the measures it intends to take to ensure it delivers efficiently and effectively and within its financial capability. Typically it will specify not only the agreed outputs but proposed management structure, operational delivery process, planned productivity improvements, IT strategy, outsourcing strategy, human resource planning including training, health and safety issues, investment plan, performance indicators and targets, projected income and expenditures, balance sheet and cash-flow, among others.

4.4.6 Human resources

114. RNCMNR employs over 6,500 people, of whom about 550 are at the Headquarters and the remaining 6,000 in the Regional Offices. There is concern with the RNCMNR head office

employment and its allocation to directorates, for example the technical directorate seems understaffed. The regional offices have an excess of unskilled employees reflecting the 'force account' labor used in maintenance. Based on a relatively recent consultancy report[6], there is a shortage of several kinds of technical skills both at headquarters and the regional offices.

115. RNCMNR employees are not subject to civil service laws and wages are determined by a collective labor agreement between RNCMNR and two unions. The performance assessments and reviews are complex. Training is required for underperforming employees, but it seems to have no effect on salary increases or promotion. The key issues of low salaries and promotions are not based on competency and performance but on longevity of service.

4.4.7 Summary and Recommendations for RNCMNR

116. In summary, the corporate responsibilities in RNCMNR are not clear; there is a shortage of competent staff in project preparation from concept to completion, especially in planning and design; accountability is undefined; performance of staff and organization as a whole is not monitored or rewarded; modern road management systems are not used although they are available; decision-making is not based on defined criteria about benefits, costs and equity; the budget structure and the budgeting process do not lend themselves to support or evaluate goal oriented road sector strategies; there is a high level of political influence on project prioritization in the budgeting process; and there is instability in top management: the General Manager of RNCMNR and his key deputies have changed seven times since 2003.

117. The Review therefore recommends that the government should make MOT and RNCMNR, as applicable, to:

- Articulate a vision and mission statements for RNCMNR consistent with the updated National Transport Strategy (refer to Section 2.2).
- Revise RNCMNR's organizational structure to be consistent with its mission. The roles and responsibilities of the Head Office and the Regional Offices need to be clearly defined. The department for planning and programming must be strengthened. Greater resources should be directed to program evaluation and reporting, and improving road traffic safety.
- Review the functional classification of roads and develop design, structural and maintenance standards by functional and traffic volume classes. The maintenance standards should be developed as the first priority.
- Institute annual surveys of road user satisfaction with the quality of road maintenance in summer and winter.
- Incorporate the road asset management systems—based on HDM4 and the bridge management system—into the annual planning, programming, and budgeting process and ensure that the road and bridge data are reliable and up-to-date.
- Update human resources in order to ensure that hiring, promotion, and training meet the corporate needs of RNCMNR. A separate Human Resources Review of Romania's public administration provides details to this effect.
- Develop and conclude Performance Agreement between MOT and RNCMNR, and restructure the road budget to serve the planning, monitoring and evaluation of RNCMNR

[6] NEA (2007). "Immediate Technical Assistance for Management. Review of RNCMNR", The report also has a useful discussion on the responsibilities of the RNCMNR and its Regional Offices and their current legal basis.

mission, its strategic directions, and the objectives and targets. Consideration should be given to lessen possibilities for corruption and political interference (beyond what is contained in the strategic directions and the Performance Agreement) when deciding the new budget structure.

- Restructure the road sector budget to be policy-oriented allowing expenditures to be mapped onto budget categories.
- Put in place an annual cycle of performance monitoring on the basis of the Performance Agreement. RNCMNR should collect the data to enable monitoring and to take corrective actions when necessary. The MOT would review the results twice yearly and also take corrective actions with means available to it.
- Put in place a road user charge system which is consistent with the EU directive and allocate these funds to the development and maintenance of all public roads using well-founded equitable criteria.
- Implement the Corporate Governance improvements recommended in Section 3.
- Consider reconstituting RNCMNR as an infrastructure management and maintenance company, with asset ownership and determination of strategic directions and main priorities of the road network falling directly to, and appearing within the accounts of, the State.

4.5 Other Entities

118. The detailed assessment under the Review was limited to the largest transport infrastructure providers RNCMNR and CFR SA, and state-owned transport service providers CFR Călători and CFR Marfã. The assessment has also identified the following issues that need to be addressed concerning the Romanian Automobile Registry (RAR) and the Romanian Road Transport Authority (ARR).

119. RAR's core functions are vehicle registry, technical inspections of vehicles under 3.5 tons, and certification of all road vehicles and spare parts. It has 1,500 employees, and it sets fees—unregulated—for its services with the objective of balancing its accounts, since it is an off-budget agency (*regie*). RAR has offices throughout Romania, and it competes with privately owned automobile technical inspection franchises. The limited number of interviews conducted by the Review point to the fact that the quality of service provided by RAR may not be commensurate with the high level of fees set by RAR, and that citizens may not be receiving value for money from RAR's services. The MOT should review in detail both the organization and performance of RAR to ensure that the unregulated fees are not giving RAR disincentives to enhance its efficiency. The MOT should also make a decision on the role of RAR in the competitive market of automobile technical inspection in line with the MOT's private sector participation policy. As part of the review of RAR, the need for certification offices in more than one location in Romania should be assessed.

120. ARR's core function is issuing permits and licenses for road goods vehicles of more than 3.5 tons and for road passenger transport vehicles of 9 or more passengers. It also ensures technical inspection of the vehicles it licenses. ARR's mission is similar to that of AFER for railways, ANR for naval transport and AACR for aviation. ARR has between 600 and 700 staff. ARR proposes its rate structure and levels to the Minister who reviews and approves them. ARR must balance its account, and it is an off-budget authority. As in the case of RAR, the MOT

should urgently review the performance of ARR. The MOT should also ensure that any new structure addresses the possible conflict of interest in ARR’s two key functions—licensing and inspection.

121. There is a need to seek higher service standards and efficiency from both RAR and ARR. In addition, worldwide experience shows that the domains in which both RAR and ARR function are highly conducive to corruption. The MOT should therefore (i) introduce performance agreements with RAR and ARR to monitor and enhance their performance, (ii) strengthen and speed up the automation and computerization of the processes of both RAR and ARR, and (iii) put in place mechanisms for citizens and businesses to provide feedback on the service levels they receive from RAR and ARR.