

Hunya, Gabor

Research Report

Privatization Disputes in Romania – the Petrom Case

wiiw Research Report, No. 337

Provided in Cooperation with:

The Vienna Institute for International Economic Studies (wiiw) - Wiener Institut für Internationale Wirtschaftsvergleiche (wiiw)

Suggested Citation: Hunya, Gabor (2007) : Privatization Disputes in Romania – the Petrom Case, wiiw Research Report, No. 337, The Vienna Institute for International Economic Studies (wiiw), Vienna

This Version is available at:

<https://hdl.handle.net/10419/204109>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Forschungsberichte

wiiw Research Reports | 337

Gábor Hunya

Privatization Disputes in Romania – the Petrom Case

March 2007

Gábor Hunya is a research economist at the Vienna Institute for International Economic Studies (wiiw). Research for this paper was supported by OMV Aktiengesellschaft.

Gábor Hunya

**Privatization Disputes
in Romania –
the Petrom Case**

Contents

<i>Summary</i>	<i>i</i>
1 What is the issue?	1
2 Energy consumption, import dependence and the role of Petrom.....	3
<i>Energy intensity</i>	3
<i>Production, imports and energy security</i>	4
<i>The role of Petrom in the Romanian energy market</i>	7
3 Overview of the privatization process in Romania.....	7
<i>The legislative framework</i>	8
<i>Main features of the Privatization Law No. 137/2002</i>	10
<i>Privatization practice in the 2000s</i>	12
<i>Privatization still incomplete</i>	13
4 The circumstances of Petrom's privatization	15
5 Controversial aspects of the Petrom privatization treaty in the 2006 discussion	20
<i>Selling price and evaluation method</i>	20
<i>Concession rights and royalties</i>	23
<i>Penalties</i>	23
<i>Tax debts written off and budgetary credit for environmental damages</i>	24
<i>Concluding remarks on the Petrom contract</i>	25
6 Performance of Petrom after privatization	25
<i>Production cuts</i>	25
<i>Investments</i>	26
<i>Employment cuts</i>	27
<i>Taxes and royalties paid to the state</i>	27
7 How to make gas prices affordable for the population?	30
Conclusions	33
Literature.....	35

List of Tables, Figures and Boxes

Table 1	Primary supply-based (TPES) and consumption-based (TFC) energy intensities, 2004 tonnes of oil equivalent (toe) per million EUR of GDP at PPS.....	4
Table 2	Import dependency ratios for crude oil and natural gas, 2004 ratio of imports (plus changes in stocks) over total domestic use	4
Table 3	Romanian production, consumption and imports of natural gas, thousands of tonnes of oil equivalent, ktoe	5
Table 4	Romanian production, consumption and imports of crude oil thousands of tonnes of oil equivalent, ktoe	5
Table 5	Romania's imports of natural gas by country of origin, 2004	6
Table 6	Romania's imports of crude oil by country of origin, 2004.....	6
Table 7	Petrom overview, in RON million.....	26
Table 8	Investments by Petrom	27
Table 9	Price of natural gas for households and for industrial consumers, EUR per Gigajoule (GCV), average 2005.....	30
Figure 1	Evolution of Petrom share prices on the Bucharest Stock Exchange.....	29
Figure 2	Evolution of Petrom trading volumes on the Bucharest Stock Exchange	29
Box 1	Main features of the OMV Corporation	18
Box 2	Petrom's strategy for 2010	28
Box 3	Household energy subsidies in the United Kingdom.....	32

Summary

In 2004 the Austrian-based OMV acquired in a privatization process 51% of the Romanian national oil company Petrom. Two and a half years later this privatization is again in the focus of political attention in Romania. The current government and the media consider the selling price and the royalties too low in view of the high international oil and gas prices. The whole issue of privatization is on the agenda. This paper investigates the privatization of Petrom in its historical context and deals with its consequences.

In 2003-2004 the privatization of large companies was seen as a prerequisite to put an end to non-transparent subsidization, rent-seeking and favouritism in the Romanian economy. The Petrom sale was urged by the necessity to obtain from the EU Commission the 'functioning market economy status' and to close all negotiation chapters by the end of 2004. Fair and open bidding resulted in selecting the winner and setting the sales price. The conditions of privatization, the sales price and other stipulations of the privatization process reflected the then level of knowledge and the risks associated with a Romanian company. Meanwhile, due to high international oil prices and the improved business conditions in Romania, an EU member as of 2007, the value of the company is now certainly higher than it was two years ago – which also benefits the Romanian state as (direct and indirect) holder of 40% of Petrom's shares.

It is debatable how far the recent increases in international oil prices could be foreseen in 2003, but it is quite certain that the International Energy Agency and large oil companies did not expect such a development. Still, the high oil prices benefit Petrom, and the large one-time profits finance investments.

The sale of Petrom to OMV and its subsequent restructuring stabilized the company. New technologies, management techniques and organizational structures have increased efficiency. The company envisages the production decline to come to an end in 2007; explorations in Kazakhstan will add to Romania's supply in the future. As a further advantage, Petrom is the OMV subsidiary in charge of the company's business in the CIS and in Southeast Europe, Bucharest becoming the regional headquarters.

The discussions around the OMV–Petrom case should have no relevance for greenfield investments in Romania, but large-scale privatizations particularly in the energy sector suffer delays. The government has stalled a number of important privatizations thus nurturing potential hotbeds of corruption.

Key words: privatization, oil and gas security, gas price, Romania, Petrom, OMV

JEL classification: F23, L33, L71, P26, P31, Q38

Privatization disputes in Romania – the Petrom case*

1 What is the issue?

The privatization of the Romanian national oil company Petrom is again in the focus of political attention in Romania, two and a half years after the Austrian-based OMV acquired 51% of the company's shares. Legal investigations are in progress against former employees of the Ministry of Economy and Commerce (MEC) and consultants who were involved in energy sector privatizations for leaking classified information.¹ The Supreme Defence Council of Romania ordered the investigation of all large privatization cases of the recent years in search for corruption. The upper house of the Romanian parliament, the Senate, on 12 December 2006 approved the forming of a special commission to investigate the privatization of Petrom. In the extreme case, the commission may come up with suggesting to nullify the law on the Petrom privatization, although it has very weak prerogatives to push such an initiative through Parliament.

Petrom had come into the limelight when it increased petrol prices in September 2005. The gas price rise announced in November 2006 has stirred further discontent and 'revelations' by the media. Price rises were widely interpreted as hostile actions of the foreign owner. While in 2005 the dispute had died off, in 2006 the privatization contract of Petrom was made public and discussed in details. Many analysts interpreted its content as being unsatisfactory, in fact harmful to Romanian interests. They found the sales price meagre, the royalties on the reserves too low and the tax relief on the geological quota unjustified, just as the ten-year tax-guaranty for the exploration and production sector.²

It is quite obvious that the current controversy concerning the Petrom privatization has to do with the 2006/07 political context in Romania. The current government does not enjoy a stable majority in Parliament, thus early elections may be announced any time and forces within the governing coalition compete for a better position. There have been fractures in the coalition and the Conservative Party left its ranks when its economy minister resigned in December 2006. A split in the governing Liberal Party and the constant dispute between Prime Minister and President have also contributed to the surfacing of all sorts of allegations. The oppositional Social Democratic Party, in power between 2001 and 2004, still enjoys widely acknowledged merits of guiding the country into the European Union. Back in 2004 the privatization of Petrom was interpreted as a major success that paved the

* Research for this paper was supported by OMV Aktiengesellschaft.

¹ See *Nine O'Clock*, 27 November 2006, 'Minister Seres suspected of trading classified information'; *Hotnews.ro*, 22 November 2006, 'Prosecutors hear Petrom contract negotiator'.

² See *Ziua*, and *Nine O'Clock*, 24 November 2006, 'New surprises as Petrom privatization clauses are disclosed'.

way to closing the accession negotiations at the end of that year. In May 2007 elections to the European Parliament will take place, thus it has again become important for the currently ruling centre-right coalition to downgrade the role of the Social Democrats in the EU accession process.

Now that Romania is an EU member, national pride is stronger at work and privatization to foreign investors is less popular than few years earlier. The wider context is provided by increased concerns in Europe about energy security. Also in other EU member states disputes have arisen about privatization and there is growing disharmony between the EU Commission and member states over the ownership unbundling of energy networks.

An additional Romanian problem is that domestically produced gas is sold at half the price of imports, which is against EU norms. Prices will have to be unified at world market level within two years. The government is undecided when to increase prices and how to support socially weak private consumers.

According to Varujan Vosganian³, Minister of Economy and Commerce, the current government will obey contracts and does not wish to renegotiate the Petrom privatization. But he declared being firmly convinced that the former government had made a wrong deal, against the interests of Romania. What he intends to achieve in negotiations with the OMV is that the Romanian state receives a higher share of the windfall profits Petrom earns from the currently high international prices. The government would like to cash from Petrom contributions which would subsidize gas for poor household consumers. Challenging in the press the content of the 2004 privatization agreement can be seen as a way to put pressure on the oil company.

Another point of controversy is the performance of Petrom after privatization. In 2006 the company registered a lower oil and gas output, much lower employment, but higher profits than before being taken over by OMV. Two years after privatization, the company is in the midst of organizational restructuring, modernizing and cost cutting investments, and streamlining labour force. Subcontracting to domestic suppliers shrank by imposing strict quality standards; services have been increasingly imported from Austria; many of the management were replaced by expatriates – all these being measures that have hurt local interests. The management of OMV and Petrom is confident that things have improved and will soon get even better. They envisage a consolidated company with positive profits even at lower international oil prices while the production decline is to stop in 2007. Investments are to increase further, replacing most of the outdated technical facilities with up-to-date technology. In addition, Petrom is on the way to becoming the regional headquarters of OMV for Southeast Europe including Bulgaria, Serbia and Macedonia,

³ Private communication to the author, 15 January 2007.

and also for the CIS countries with major activities in Kazakhstan and Russia. It seems however that a significant part of the Romanian politicians, press and public is unimpressed by the restructuring results and the bright prospects of Petrom. Some political forces exploit the situation as a source of popular support to present the country as the victim of international capital.

In these circumstances we find it important to look more closely into the facts and evaluate the impact of the Petrom privatization on the Romanian economy. In a wider context, the discussion is about privatization itself, a fundamental prerequisite for the functioning of a market economy. The discussion has to start from the economic and political conditions at the time of the Petrom privatization. They were much worse than in 2007. In the past two to three years, economic conditions in Romania have improved a lot, doing business is easier and stock prices have risen not only for Petrom.

The aim of this paper is to investigate the components of the current debate in Romania related to the privatization of Petrom and its wider context. First we analyse the energy dependence of Romania and the role of Petrom in ensuring oil and gas supply (Chapter 2). Then we look at the main features of privatization in Romania, focusing on the years 2001-2003 when the sale of Petrom was decided (Chapter 3). Chapter 4 describes the political and economic circumstances of the Petrom privatization. The widely discussed 'controversial' aspects of this deal are presented in Chapter 5. Then we turn to the achievements of Petrom after privatization (Chapter 6). After a brief detour discussing the issue of household gas prices (Chapter 7) we conclude.

2 Energy consumption, import dependence and the role of Petrom⁴

Energy intensity

Romania's energy intensity looks quite high in nominal terms, if one takes the ratio of energy supply or of energy consumption over GDP at current prices. In such a case, few EU member states appear more energy-intensive than Romania, the notable exception being Bulgaria. On the other hand, if one measures GDP at Purchasing Power Standards (PPS), Romania's ranking improves markedly. For comparative purposes we decided to construct a peer-group for Romania which we feel should constitute a good benchmark for the country. In this peer-group we include the four larger EU member states that joined the Union in 2004: Poland, the Czech Republic, Hungary and Slovakia, as well as Bulgaria. Looking at the two measures which best reflect a country's energy intensity, namely the ratio of the country's total primary energy supply over GDP at PPS, and the country's total final consumption of energy over GDP at PPS, we find in both cases that Romania

⁴ This chapter is based on research done by Edward Christie, wiiw research economist.

occupies an intermediate place in this peer-group, slightly above the peer-group's weighted average, as shown in Table 1 based on the database of IEA (International Energy Agency, 2006). Both indicators yield an identical ranking for each country. The difference between the two indicators is due to the fact that total primary energy supply (TPES) includes transformation and network losses, whereas total final consumption (TFC) does not. These losses in Romania are lower than in the peer group.

Table 1

Primary supply-based (TPES) and consumption-based (TFC) energy intensities, 2004

tonnes of oil equivalent (toe) per million EUR of GDP at PPS

Country / region	TPES / GDP PPS	TFC / GDP PPS
Bulgaria	351.5	188.5
Slovakia	283.7	175.7
Czech Rep.	278.8	169.3
Romania	244.0	162.5
Peer-group total	238.0	153.0
Poland	217.0	143.9
Hungary	188.7	137.1

Source: IEA, wiiw and own calculations.

Production, imports and energy security

Thanks to its domestic production, Romania is less vulnerable to external factors than most other European countries. This is particularly the case with natural gas (Table 2). While the other countries in Romania's peer-group have import dependency ratios approaching 100%, Romania is in a safer position. In 2004 it had to import only 26% of its gas need and 55% of its crude oil need.

Table 2

Import dependency ratios for crude oil and natural gas, 2004

ratio of imports (plus changes in stocks) over total domestic use

Country	Czech Rep.	Slovakia	Hungary	Poland	Bulgaria	Romania
Crude oil	92%	96%	77%	95%	100%	55%
Natural gas	98%	97%	80%	67%	89%	26%

Source: IEA, wiiw and own calculations.

Romania's import dependency for natural gas has fluctuated between 18% and 29% over the past ten years (Table 3). As for the relationship with respect to reserves, the BP (British Petrol) Statistical Review of World Energy (June 2006 edition) indicates that proven reserves were estimated to be 630 billion cubic metres in 2005, equivalent to

approximately 50 years at the 2005 production level. Based on the high share of domestic production in the natural gas supply, Romania sets consumer prices for gas in part based on its domestic production costs. This is not allowed under EU regulation: internal prices must be set at the international level in order to avoid unfair competition. (See also Chapter 7.)

Table 3

Romanian production, consumption and imports of natural gas

thousands of tonnes of oil equivalent, ktoe

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Production	13760	11905	11146	11189	10965	10777	10596	10426	10374	10447
Imports	5653	4029	3834	2538	2711	2308	3129	4236	4110	4160
Changes in stocks	0	0	0	0	0	91	-100	64	-552	NA
Consumption	19413	15934	14980	13727	13676	13176	13625	14725	13933	14608
Dependency ratio	29.1%	25.3%	25.6%	18.5%	19.8%	18.2%	22.2%	29.2%	25.5%	28.5%

Remark: Dependency ratio: the numerator in the dependency ratio includes changes in stocks (for which a negative number indicates an increase in stocks), while the data for consumption include all types of losses, and are equal to total primary energy supply in IEA terminology, and to gross inland consumption in the Eurostat terminology.

Source: IEA for 1996-2004 data and Romanian National Institute of Statistics for 2005 data.

As for crude oil, import dependency has fluctuated between 40% and 55% up to 2004, but rose to 63% in 2005 (Table 4). BP reports for reserves an estimate of 468 million barrels in 2005, equivalent to approximately 11 years at 2005 production levels, in other words considerably less than is the case with natural gas.⁵ In light of this, and assuming that there will be no major new discoveries of oil fields, Romania's import dependency should continue to rise in the medium run.

Table 4

Romanian production, consumption and imports of crude oil

thousands of tonnes of oil equivalent, ktoe

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Production	6744	6642	6491	6252	6162	6101	7120	6929	5565	5059
Imports	6948	6063	5802	4198	4661	5382	6176	5065	7100	8689
Changes in stocks	-75	12	-39	-18	-111	39	-36	91	-229	NA
Consumption	13617	12717	12251	10429	10711	11522	13260	12085	12436	13748
Dependency ratio	50.5%	47.8%	47.0%	40.1%	42.5%	47.0%	46.3%	42.7%	55.3%	63.2%

Remark: See Table 3.

Source: IEA for 1996-2004 data and Romanian National Institute of Statistics for 2005 data.

⁵ BP (British Petrol) Statistical Review of World Energy (June 2006 edition).

Table 5

Romania's imports of natural gas by country of origin, 2004

	USD million	share in total, %
Russia	600.2	79.5
Turkmenistan	150.8	20.0
Ukraine	4.0	0.5
Others	0.0	0.0
Total	755.1	100.0

Source: UN COMTRADE and own calculations.

The final aspect which needs to be addressed concerning this brief overview of Romania's energy security is the pattern of imports of natural gas and of crude oil by country of origin. As is the case with other Central and Eastern European countries, Romania sources all of its imports of both types of fuel from CIS countries (Tables 5 and 6). Russia accounts for well over 50% in both cases. Some diversification is however visible, chiefly thanks to Kazakhstan and Azerbaijan in the case of crude oil, and Turkmenistan in the case of natural gas. It remains to be seen whether Romania could do more to decrease its dependency on Russian imports. One obvious possibility would be if pipeline infrastructure improved between the Caspian region and Southeast Europe, with Turkey playing the key strategic role of transit country, and/or increased throughput capacity to Black Sea terminals (for example in Georgia) for products from Azerbaijan and Central Asia. Petrom is active in expanding explorations in Kazakhstan and OMV itself is one of the main initiators of new pipeline projects such as *Nabucco*.

Table 6

Romania's imports of crude oil by country of origin, 2004

	USD million	share of total, %
Russia	1,208.7	63.0
Kazakhstan	516.4	26.9
Azerbaijan	161.7	8.4
Ukraine	30.2	1.6
Others	1.0	0.1
Total	1,918.0	100.0

Source: UN COMTRADE and own calculations.

Energy security can be seen as having two main components: security of supply and energy intensity. As we saw above, Romania's real energy intensity is close to the average of its peer-group. On the other hand improvements could still be made. But whichever way things go, crude oil import dependency is certain to rise quite significantly. The World Bank considers the following actions necessary: (i) to continue aggressively the energy sector

privatization strategy; (ii) adjust the tariffs to opportunity costs; (iii) undertake energy conservation measures, the most important being district heating where the transmission losses approximate 30% of production; and last but not least (iv) explore energy-efficient and low-carbon technologies (Saadat, 2006).

The role of Petrom in the Romanian energy market

Petrom has a strong position on the Romanian market. In terms of natural gas production, Petrom has a share of 44%, still state-owned Romgaz 52%, while small producers have 2% (Petrom Annual Report 2005). Petrom is active mainly in the Subcarpathian region where oil and gas fields complement each other. Romgaz is active mainly in Transylvanian gas fields. In oil production Petrom delivers almost the whole domestic production. In oil refining there are ten active refineries with an operational capacity of 23.5 million tons of which only 59% is being utilized. Of the 14.3 million tons processed in 2005, the share of Petrom refineries amounted to 44.7%, of which 23% was imported and the rest constituted by own production. According to Petrom plans, the decline of oil production will stop in 2007 and the level will be maintained until 2010. Own explorations in Kazakhstan will increase and contribute to Romanian imports (see Box 2 in Chapter 6 for Petrom's investment plans). As to the fuel market, Petrom had a market share of 24% at the end of 2005, which increased in 2006 when OMV stations were taken over. The chemical plant Doljchim has an about 20% share in the Romanian fertilizer market (Petrom Annual Report 2005). All in all, much of Romania's energy policy is decided by Petrom and its shareholders. While the dominant position of OMV ensures efficient operation and investments, the 40% share of the Romanian government enables it to be informed about the company and also to exert some influence on it. (The Austrian state has a similar stake in OMV. See Box 1 in Chapter 3 on OMV.)

3 Overview of the privatization process in Romania

The Romanian approach to privatization had been defensive throughout the 1990s. The successive governments tried to preserve enterprise capacities, employment, linkages and markets to the highest possible extent (Hunya, 1999). They postponed privatization and tried to restructure companies under state ownership. As in other transition countries, this policy proved incapable of yielding even the results expected by the policy makers. This was due both to the inconsistency of policies and hesitant action. The drawn-out privatization process led to output and employment declines while the assets of state-owned enterprises (SOEs) were stripped by the management and stake-holders. The Romanian way contrasted with the strategy in Hungary, which gave priority to the financial viability of firms and revenues to the public budget. By 2002, after 12 years of experience, privatization in Romania was just accelerating while in Hungary it was by and large completed. The extent of job and capacity destruction was similar in the two countries, but

only in the latter could a functioning and competitive economy be created. At the time the privatization of Petrom started, the privatization of non-utility companies was far from completed. All in all, about 40% of the Romanian GDP was still produced by the public sector, which was the highest share among the EU accession countries.

Still, progress cannot be denied if measured by Romanian standards. As of 2002 most of the small and medium-sized manufacturing companies became private. Except for the largest commercial bank (BCR) and the savings bank (CEC), all former state-owned banks were privatized or liquidated. With the corporatization of utility companies ('regies autonomes') and splitting some of them into potentially competing units, the prerequisites for future privatization had been established. The long-delayed privatization of agricultural and tourism companies started and was completed within three years. There remained a few hundred other companies, mainly large manufacturing companies in the heavy industries, for future privatization. These companies were either sound and therefore the government waited for a high-price offer, or they were heavily indebted and in arrears which made financial restructuring necessary during the privatization process.

The legislative framework

Until 1996, the main way of privatization was management-employee buy-out (MEBO) and mass privatization for vouchers (MPP); non-leveraged sales to outsiders were not frequent. The Romanian MPP differed from the most frequently quoted Czech and Polish models and also from the more recent Slovenian one in the major point that it did not stipulate for the full privatization of the companies involved. It gave a mere 30% to the public or to appointed investment funds; 70% of the shares remained with the State Ownership Fund (SOF) that was entitled with the prerogatives of a privatization agency. With the institutionalization of minority shareholders in most companies slated for privatization, ownership rights became messed up, which scared off many investors in the following years.

After 1996, case-by-case privatization by sale became the main privatization method. This policy change roughly coincided with similar developments in other Central and East European countries such as the Czech Republic and Bulgaria. By that time it was realized that mass privatization failed to generate efficiency-improving restructuring and corporate governance. But those other countries featured a much more rapid case-by-case privatization than Romania, where the political dispute concerning the 'right owner' and the 'fair price' has continued to the present day. Only under the pressure of major investors and international financial institutions could more important deals be finalized.

The lack of clarity of the privatization policy was reflected in the frequency of legal changes, and the volatility of the legal framework significantly slowed down the

privatization process. A brief description of the developments which occurred successively shows that:

- there were three 'core' privatization laws in force as of end-1996: the 1991 'Privatization Law', the 1994 'MEBO Law', and the 1995 'MPP Law';
- these were all substantially amended in May and July 1997; important additional changes came in August and September 1997, with respect to the protection of the employees of privatized companies and the destination of privatization proceeds;
- a full consolidation of the privatization legal framework, entailing many important modifications of the former laws, was carried out in December 1997; comprehensive implementing norms for the new consolidated legal framework were issued, successively, in February 1998 and July 1998;
- another comprehensive modification of the privatization legislation occurred in May 1999 (Law No. 99/1999), and implementing norms to this were issued in June 1999. The possibility of liquidating state-owned enterprises (SOEs) was confirmed by this law. It allowed the privatization agency, the State Ownership Fund, to wind up the company and sell its assets by simple auction. This happened mainly to smaller companies where the management or outsiders were not interested in buying the company in function. Larger SOEs were often inactivated if the operation proved too costly and no private owner was at hand. The authorities thought that the destruction of a company and the selling of assets would be a bigger waste than putting it idle. Some of these capacities were reactivated in 2001 by the social democratic government, an act which contributed to the increase of quasi-fiscal deficits in that year;
- in December 2000 a new privatization agency, the Agency for Privatization and State Assets Management (APAPS), was set up. But large, mainly utilities companies were subsequently removed from the APAPS portfolio and transferred to the Ministry of Industry. The Office of State Participation and Privatization in Industry (OPSPI) was set up and existed until December 2006. It privatized several utilities companies, among them Petrom, and also restructured the defence industry;
- special legislative acts of 2001 were passed for the privatization of SOEs in agriculture and tourism;
- a new legal framework for privatization was passed in March 2002, which is the basis for privatization up to the present (see details below);
- also in 2002 Government Decree No. 25 regulated the monitoring of the fulfilment of the obligations assumed under the companies' privatization contracts. Subsequently, Government Decision No. 40/2003 modified this decree. As of mid-2006, the Authority for State Assets Recovery (AVAS) still monitored 7340 sale-purchase agreements. From 1993 up to the end of May 2006, over 1450 sale-purchase agreements were terminated. Some of the companies involved were repeatedly privatized;

- on 1 May 2004, the Authority for State Assets Recovery (AVAS) was established as a public institution subordinated to the government, by the merger of the former Authority for Banking Assets Recovery (AVAB) with APAPS;
- in December 2006 the OPSPI was merged with AVAS (Government Decree 101/2006), the latter becoming the only privatization agency of the government. Since February 2007, AVAS has also the state-owned shares of Petrom in its portfolio.

In addition to the above legislative acts, legal frameworks have repeatedly been amended by the attempt to give 'blanket coverage' to very specific incentives negotiated as part of individual privatization transactions (e.g., the take-over of the domestic car manufacturer Dacia by Renault). Large privatization cases including those of Petrom have been presented to parliament and authorized by a law.

Main features of the Privatization Law No. 137/2002

This hastily constructed legislation still constitutes the main guiding rule of privatization in Romania. On 20 March 2002, the government submitted to the parliament an 'urgent legislative initiative' for the acceleration of privatization.⁶ Rather than formally cancelling the previous privatization law and replacing it with a new text, or at least making explicit amendments to the text previously in force, Law No.137/2002 is a stand-alone text. The provisions of it 'completed' those of the previous legal acts governing privatization, which became a source of inconsistency. In addition, in many cases individual issues were treated neither identically, nor in a totally different way.

Still the novelties of Law No. 137/2002 are important. This act introduced restructuring programmes prior to privatization. Such a provision provided the freedom to the government to come to whatever agreement feasible with the potential buyer. While this may have been necessary as most of the companies waiting for privatization were in financial distress, restructuring before privatization was also used to postpone divestment.

Further, the provision of the sale of state assets for a symbolic value ('1 euro') was introduced. This provision was aimed to be applied implicitly to companies in financial distress, having no or negative value, and it was considered by the government as a good method to re-capitalize companies unattractive for privatization. The government assumed that the company was worth being preserved in its scope of activity even if there would be no budget revenues from the deal. The new owner was expected to perform the financial restructuring with the maximum capital investment and minimum layoffs. Liquidation and the selling of physical assets was not allowed as a way of divestiture.

⁶ According to the Romanian constitutional procedure, such an initiative automatically becomes a law unless a censorship motion is introduced and successfully upheld against the cabinet in office. The Law No. 137/2002 went unchallenged and was enacted on 28 March 2002. It was published in the Official Journal No. 215/2002.

The 2002 law attached great importance to the issue of working out the debts incurred by state-owned companies prior to their privatization; the magnitude of these debts often reached such proportions as to render the privatization of these companies virtually impossible. The law stipulated that the principal of all debts accumulated as of 31 December 2001 towards the various components of the consolidated public budget be cancelled or reduced, and the penalties accrued for the delays in making the payments corresponding to the above debts be written off. A different treatment referred to the budgetary claims arising from some specific taxes and contributions. The exact extent of the debt alleviation granted to the companies subjected to the privatization procedure was determined on the basis of criteria established by the implementing norms issued by Emergency Ordinance 40/2002 and was in fact decided case by case in the privatization tenders. This stipulation applied to Petrom as well where the government wrote off past debts before the privatization tender and offered the company for sale with a clean balance sheet.

The 2002 law brought a further novelty in the legal framework for privatization by mandating that a 'special administration' be instituted for any company involved in a privatization procedure and until the ownership of the shares was transferred from the state to the buyer. This regime consisted in the appointment of a special administrator to which a concrete mandate was given for carrying out various activities that facilitated the sale and/or rendered the company more attractive to potential buyers: mergers, spin-offs, sales of assets, debt-equity swaps, collective layoffs, enforcement of financial discipline. During the period of special administration, the company also enjoyed a certain protection vis-à-vis some of its creditors: (i) the suppliers of utilities were mandated to agree to a re-scheduling of their claims and were expressly prevented from cutting the supply to the company as long as the latter honoured in full its current payment obligations as well as the provisions of the re-scheduling plan; (ii) public creditors were mandated to suspend any ongoing action for seizing assets and were similarly obliged to remove any sequester they may have instituted against the debtor company's assets. These provisions originated in a genuine concern arising from countless negative experiences of past privatizations: (i) companies being effectively plundered by their management during the privatization procedure; (ii) actions by third parties against the company during the privatization procedure leading to a substantial modification of its economic condition and, as a result, to the withdrawal of the prospective buyer(s); (iii) deliberate inactivity by the management, in concert with the trade unions, in taking measures that would improve the standing of the company and its attractiveness to potential investors.

In order to increase the attractiveness of the companies at privatization, in addition to the Law for accelerating the privatization process, issued in 2002, another emergency ordinance was passed which introduced a collective layoff scheme for the companies under restructuring and privatization. Generous severance payments with up to one year's

salary were applied in the case of large-scale layoffs with further benefits to those who established their own businesses instead of seeking for a job.

Based on the discussion of the privatization legislation we conclude that the legal framework valid at the time of Petrom privatization was neither very clear nor very stable. Any investor calculated with risks related to a contractual relationship with the Romanian government. Still this framework was better than the former one and allowed the lasting privatization of large SOEs.

Privatization practice in the 2000s

Privatization accelerated as compared to previous years. The new government in office from late 2000 and led by the social democratic party Prime Minister Adrian Nastase increased cooperation with international organizations and set EU accession as its primary goal. As one of the accession objectives, the establishing of a 'functioning market economy' became necessary which included the privatization of the economy and the introduction of a competitive market environment. The 2001-2004 Government Programme acknowledged the necessity of deep changes in the principles and efficiency of this process and the government received detailed international support to progress with privatization.

The World Bank provided facilities to finance some of the major actions necessary. The Private Sector Adjustment Loan (PSAL) financed international consultants, capacity building and some restructuring measures for large enterprises; this made it possible to put in place a privatization process according to international standards. Under the RICOP Programme of the European Union which had started a year earlier, 60 companies were selected where APAS could rely on financial and consulting assistance (they privatized 18 of them by the end of 2001).

The major success story of 2001 was the sale of the huge steel mill Sidex Galati, which later turned out to be a successful deal by becoming an important part of the Mittal Steel Holding. Two oil refineries were privatized of which 'Rafo Onesti' was later considered a failure and Petromedia a success. Debt forgiving for companies in the privatization process was applied in large scale in most of the important cases. The huge debts of Sidex were transformed into shares, and bought by the foreign investor ten times cheaper. The oil refinery 'Rafo Onesti' had also debts converted into shares of the company by a conversion rate of 10% and APAPS sold the shares to the buyer of the oil refinery. Petromedia, when privatized to 51% in February 2001, received total debt forgiving just as Petrom a few years later. Flexible financial solutions for restructuring companies' debts could ease privatization.

The gains through privatization should be calculated first in the short run, as an effect of the privatization deal, then later on as a balance of public commitments and the performance of

the privatized firm. A calculation of the short-term gains of the Sidex privatization showed that the net positive effects for the state budget appeared three years after privatization, due much less to the acquisition price than to the fact that losses did not affect the budget any longer. Written-off old debts constituted a loss for the state budget, but there was no real possibility to receive it anyway from a permanently loss-making company. The decisive gain from privatization was that the investor had the capital and skills to restructure the company and make it profitable (Voinea, 2003). Other investors enjoyed similar trust but failed to produce the necessary turnaround in the company during the first five years after takeover, such as OTE in Romtelecom and Noble Ventures in the steel company CS Resita. Voinea (2003) explains that the latter investors received a number of local incentives that would have been sufficient to manage a turnaround in the company, but the investors did not have the skills to operate internationally and failed.

For the privatization of the largest commercial bank, BCR, the deadline was set for the beginning of 2003. Because of the international economic circumstances, the privatization strategy had to be modified so that only a minority blockage share package (25% plus 2 shares) was sold to two well-known international financial institutions, EBRD and IFC. These initiated a restructuring which then enabled the government to sell the bank to Erste Bank at a remarkably high price in 2005.

As illustrated by the above examples, privatization in Romania was not an easy task in 2002-2004. Under the then conditions, the privatization of Petrom was considered a success which improved the credibility of the government and earned Romania the title of a 'functioning market economy', which paved the way for finalizing EU negotiations by the end of 2004. (For details of the circumstances of Petrom's privatization see below.) Nevertheless, also at that time the privatization process was heavily debated and there were press reports on allegedly fraudulent privatizations. (For a well-researched overview see Radu, 2005.) Still the main privatizations, Sidex, BCR and Petrom, could not be challenged along the corruption line. Having turned into subsidiaries of important transnational companies, these largest Romanian firms have improved efficiency and confirmed their standing in an international competitive environment.

Privatization still incomplete

At the beginning of June 2006, AVAS had 441 companies in its portfolio, of which 64 were majority state-owned including 22 large companies (www.avas.gov.ro). Little progress was achieved through the year due to cumbersome procedures and, in many cases, the unattractive situation of the companies offered for sale. The plan for 2007 includes the privatization of 62 companies of which 27 are those taken over from OPSPI.

Romgaz is certainly the biggest remaining state-owned enterprise; in the banking sector this is the savings bank, CEC. There was a half-hearted attempt to sell CEC in late 2006,

but the price offered was declared unsatisfactory and the bank remained in public hands. Romgaz' privatization is in stand-by: both President Basescu and the opposition leaders consider it not being a priority. The energy sector is understood as sensitive. It is widely quoted that many EU countries maintain a national stronghold on energy companies, e.g. Gaz de France, which bought part of the gas distributor Distrigaz in Romania. The government may list a small part of Romgaz on the Bucharest stock exchange in 2007 and then issue new shares to finance investments in the company. The four remaining energy distribution companies are in the 2007 privatization plan of AVAS, but no government decision has been passed yet. Under the maturing market economy conditions in Romania, privatization through the stock exchange would be a feasible alternative to a foreign strategic owner. But the capacity of the Bucharest stock exchange does not allow to carry through the envisaged amount of share issues.

AVAS is also left with minority shares in a number of companies. According to the 2007 plans, in 95 cases the majority owner would buy them, in 265 cases the shares will be offered on the Bucharest stock exchange. (See <http://www.avas.gov.ro/index.php?lang=ro&id=3620>.) If these plans are successful, 2007 will be the year of the largest amount of stock exchange privatization. AVAS also holds the state-owned shares of Petrom.

While the government organization in charge of privatization is doing its job, the political support seems to have faded. The fate of CEC can be considered as symptomatic. The bank had a monopoly over household accounts some 15 years ago but has lost market shares ever since. In 2006 the CEC market share dropped to 4.1%, as against 4.3% in the previous year. But CEC also implemented some restructuring and has turned profitable.. The government expected a sales price of EUR 700-800 million, but the highest offer (coming from the National Bank of Greece) was only EUR 500 million. The government decided to withdraw from privatization and recapitalize the bank from own resources. Opponents to further privatization praise the decision as the budget is in no need of further privatization revenues, and the Romanian countryside would need a strong commercial bank.⁷ It is interesting that privatization itself, not the method of selling to a strategic investor, has been questioned. While privatization is necessary just to diminish political influence on business, privatization resulting in dispersed ownership may preserve the special characteristics of the bank. Unfortunately, the current government has used the Petrom debate to keep major companies under state control and preserve potential corruption hotbeds.

The common feature in the Petrom and the CEC privatization debates is the wrong belief that only state ownership can secure public interest, whatever that may mean. Specifically

⁷ See Ilie Serbanescu, 'CEC was not about the money!', *Nine O'Clock*, 17 January 2007. Interestingly enough, for the same author OMV is 'not exactly a private company'; Ilie Serbanescu, 'Central and Eastern Europe adrift in political sea (II)', *Nine O'Clock*, 8 September 2006.

this can mean low gas prices for the population and low interest credits to farmers. But social support should not be provided via non-market prices offered by state-owned companies. Subsidies can be given directly to consumers even if the producer is private and operates in competitive circumstances. (See Chapter 7 for different scenarios.)

4 The circumstances of Petrom's privatization

Petrom's privatization constituted part of the government's energy sector restructuring programme for 2001-2004, elaborated in cooperation with the IMF, the World Bank and the EU. The main problems to be solved during privatization included the arrears of fees to this sector and the sector's arrears to the state budget. Energy companies functioned as channels of quasi-fiscal subsidies to the economy. A cross-subsidization of inefficient and un-restructured SOEs distorted the economy and impeded fair competition. To overcome the problem, the main energy users were included in the privatization process, which would eliminate them from the list of arrear seekers. On the other hand, the energy sector had to be put on an economically viable basis by restructuring and later privatizing the distributors.

In 2002 the Office of State Participation and Privatization in Industry (OPSPI) offered 26 economic agents for privatization, among them 5 companies within the programme of the World Bank-supported PSAL II: SNP Petrom, Distrigaz Sud, Distrigaz Nord, Electrica Dobrogea and Electrica Banat. The EUR 340 million World Bank loan of PSAL II was disbursed in two tranches, in October 2002 and July 2004 (World Bank, 2005). The second disbursement coincided with the successful completion of the Petrom privatization. In fact, the whole privatization process in those years was under the scrutiny of World Bank experts. Recognizing that past transactions had often been the subject of criticism due to non-disclosure, reports of private deals, insider transactions and related charges, the Bank set out to closely monitor the progress of implementation without directly influencing the decision-making process. As the main merit of privatization, the report (World Bank, 2005) stresses not the direct budget revenues but the reduction of related fiscal losses and laying the ground-work for a private sector-led economy.

The 2002 Pre-accession Economic Programme (Romanian Government, 2002) revealed the main aims of the government in the context of the Petrom privatization: 'The general strategic objective of the hydrocarbon extraction and processing sector is the immediate and medium-term meeting of the energy bearer's requirements at the lowest price possible, achievement of a maximum hydrocarbon production in economic efficiency conditions, at the same time ensuring an important reserve covering degree, in conditions of safety, quality and environmental impact restriction.' The government also decided to take action independently of the outcome of the privatization. 'In order to maintain for the next years at least the current levels of oil and gas production, the companies of this sector (Romgaz and Petrom) have started a series of projects and partnerships in all the domains

from their field of activity: geological research, exploration, development, production (oil and natural gas) and underground storage of natural gas, their objective being discovery of the highest possible structures with hydrocarbon accumulations, which are going to be tested in the near future. The financial effort for these projects is estimated, at about 1 billion euro for the period 2003-2006, and it will be ensured from internal and external sources.’⁸ The restructuring and investment project had thus started before privatization despite the fact that Petrom was not organized as an efficient company.

In addition to financial and expert support from international organizations, the Romanian government was also under political pressure to fulfil the conditions of EU membership. Having started accession negotiations in 2000 and receiving in 2002 a target accession date 2007, the Romanian authorities became more and more involved in various exercises preparing the country for EU accession. This process was mainly dictated by the European Commission through the annual monitoring reports. In the economic field, the Romanian government was set the task to improve its economic programming activity by preparing each year a pre-accession economic programme (PEP) starting with the year 2001. The EU accession negotiations had to be completed by the end of 2004, and the privatization of Petrom was perceived as a conditionality for the successful completion of these negotiations. The EU Commission required Romania to finalize the privatization process in industry (EU Commission, 2002); later on, the privatization of Petrom was mentioned in the Energy Roadmap adopted by the Government Decision No. 890/2003.

The need for accelerated action became even more obvious when Bulgaria closed its EU accession negotiations while Romania was in delay. Reacting to the delays in Romania's negotiation schedule, the EU Commission contemplated to decouple the country's projected January 2007 accession date from that of Bulgaria. The chapters still open for Romania included those on justice and home affairs, environment, competition, and the free movement of services (see EurActiv, 15 June 2004). The competition chapter was directly linked to the enterprise and energy sector reforms. Due to successful privatizations, the mid-October 2004 EU progress report gave Romania the long-desired qualification of a ‘functioning market economy’ and all chapters of the treaty were closed by the end of the year.

In these circumstances, the privatization of Petrom could be professionally prepared and was set for success. But many of the current attacks against the Petrom deal in fact question the above reasons and merits of privatization and claim that that company was different. Petrom was not a plain loss-maker, although its financial situation was less than transparent (see Chapter 5). At the time of privatization, Petrom was a vertically integrated

⁸ The amount of capital investment foreseen by the government was invested by Petrom in the two years 2005 and 2006, EUR 1082 million as reported by the company. According to Petrom's Strategy for the following two years this amount is to be invested annually.

company which developed exploration activities, crude oil and natural gas extraction, refining-processing, oil-chemistry and petroleum products transportation and owned a distribution network that covered about 49% of the market (Romanian Government, 2001). It had two refineries with integrated petrochemicals complexes (Arpechim and Petrobrazi). The Romanian state was the owner of Petrom through the Ministry of Industry and Resources, which owned 93.225% of the shares; the rest of 6.775% belonged to private shareholders, natural and legal entities (of which 3.404% natural persons and 3.372% legal entities). Petrom employees were given the pre-emptive right, stipulated in the statute, to buy shares at the nominal value, amounting to 10% of the company's registered capital, from the state-owned share.

The PSAL II financed the involvement of international consultants on behalf of the Romanian government. These consultants were selected and had a role in achieving a due diligence analysis, the feasibility study and a proposal for privatization strategy, as well as assisting in the privatization process. For Petrom the consortium formed by Credit Suisse First Boston and ING Bank was chosen.⁹ In compliance with the provisions of this contract, the consultants submitted the feasibility study that also included the privatization methods applicable to Petrom. They suggested to sell Petrom as an integrated company for oil exploration, exploitation, transport and refining as well as oil products distribution. The sale announcement was published on 26 August 2003. There were 15 initial letters of interest for Petrom, including big names such as Gazprom, ConocoPhillips, Glencore, British Petroleum (in a consortium with TNK); four of them were rejected on technical grounds, including that of Halliburton. Another four of the eleven remaining companies did not make an offer. Three companies were selected for final financial offers: OMV, MOL (Hungary) and Occidental Petroleum (USA). MOL was rejected because its offer included a mutual change of shares, and Occidental wanted to acquire only parts of Petrom activities. OMV offered the highest price and the best conditions compared to the other bidders. The winner was announced on 21 May 2004 and the privatization contract signed with OMV on 23 July 2004. (See Box 1 for main data on OMV.)

The deal received the go-ahead from the Competition Council provided that OMV sold 25.1% of Rompetrol, the main local competitor of Petrom, in order to make the economic concentration compatible with a normal competitive environment. The contract was passed through a special law No. 555 / 2004. The Competition Council also checked the financial stipulations of the contract and found that no state aid was provided for OMV. The main argument of Decision No. 361 was that the conditions for privatization in terms of debt write-off, concessions etc. were the same for all bidders and not discretionary.

⁹ The appointment was approved by Government Ordinance 1450/2002.

Box 1

Main features of the OMV Corporation in 2005

With OMV as majority owner, Petrom is part of the largest oil and gas group in Central and Eastern Europe, with oil and gas reserves of over 1.4 billion barrels of oil equivalent (boe), daily production of around 340,000 boe and an annual refining capacity of 26.4 million metric tons. OMV now has over 2,457 gas stations in 13 countries. The market share of the group in the Refining & Marketing business segment in the Danube Region is now approximately 18%.

With Group sales of EUR 15.58 billion and a workforce of 5226 employees, as well as market capitalization of approximately EUR 14.76 billion, OMV Aktiengesellschaft is Austria's largest listed industrial company. As the leading oil and gas group in Central Europe, OMV is active in Refining and Marketing in 13 countries and has set the goal of reaching a 20% market share in the region by 2010.

OMV Facts:

- Austria's largest listed industrial company
- Leading oil and gas group in Central Europe
- Explorations and Production activities in 18 countries on five continents
- Consolidated sales: EUR 15.58 billion | EBIT: EUR 1.96 billion
- Market capitalization: EUR 14.76 billion
- 5226 employees
- Stockholder structure: ÖIAG (Austrian state) 31.5%, IPIC (Abu Dhabi) 17.6%, free float 50.9%

Important stakes:

35% stake in Borealis A/S

50% stake in AMI Agrolinz International GmbH

10% stake in the Hungarian MOL group

45% stake in BAYERNOIL Raffineriegesellschaft mbH

50% stake in EconGas GmbH

51% stake in Petrom SA

34% stake in the Turkish Petrol Ofisi

(based on www.omv.com)

On 14 December 2004, OMV closed the acquisition of a 51% stake in the largest Romanian company.¹⁰ For the acquisition of 33.34% of Petrom's shares, EUR 669 million was paid to the Romanian state. OMV increased its stake to 51% by additionally paying EUR 830 million into Petrom. This amount was to be used for future investments in Petrom. Following this act, OMV held 51% of Petrom's shares, the Romanian government 40.74% and EBRD 2.03%, with a free float of 6.23%. The government later offered part of its shares to the Property Fund set up for restitution claims. As a result the current shareholder structure is: OMV 51%, Romanian state 30.862%, Property Fund SA 9.887%, European Bank for Reconstruction and Development 2.026%; 6.214% are owned by minority shareholders. The company is listed on the Bucharest stock exchange.

¹⁰ Petrom press release, 14 December 2004; www.petrom.ro.

OMV has the full right to run the current business of the company and to form its strategy. The Romanian state has the right to safeguard the general direction of activity, aspects of safety of operation and control the fulfilment of stipulations of the privatization contract. Minority shares quoted on the Bucharest stock exchange either directly or through the Property Fund provide stock prices which give an important feedback to the major shareholders concerning the valuation of their property. The EBRD considers itself as the safeguard of minority ownership rights. According to the EBRD, 'the Bank is continuing to support privatization in Romania by converting up to \$73 million of its outstanding debt for an equity stake of around 2 per cent in Petrom. The Bank's presence should also ensure continued transparency of the privatization process, as well as protection for minority-shareholders rights, which includes local employees'.¹¹

At the time of the takeover, Petrom had approximately 1 billion barrels of oil equivalent (boe) of oil and gas reserves and daily production of about 220,000 boe from around 300 oil and gas fields, including around 15,000 onshore Romanian production wells as well as offshore assets in the Black Sea and exploration and production concessions in Kazakhstan. It produced approximately 6 million tonnes of crude oil and 6 billion cubic metres of natural gas in 2004. It had a refining capacity of 8 million metric tons and operated over 600 filling stations in Romania and neighbouring countries. In 2003 the sales revenue of the group was EUR 2031 million, EBITDA was EUR 342 million and EBIT was EUR 26 million. Alongside the actual privatization, significant framework conditions for conducting business successfully were also established. These include the indemnity by the Romanian government for historic contamination and the stability of fiscal conditions in the upstream sector for the next ten years. These provisions, later 'discovered' as 'secret stipulations', were published in the Petrom press release of 14 December 2004.

As stressed by the critics, at the time of its privatization Petrom was not a black hole of the economy, no chronic loss-making company. Its financial situation was at least complicated. It recorded losses in 2002 and 2004, but it also recorded profits in 2001 and 2003. Its operating profit in 2003 was EUR 121.9 million and the net result was EUR 38.4 million, in 2004 its net result (EUR -240.2 million) and operating profit (EBIT = EUR -143.3 million) were in the red. Considering the results by end-2003, Petrom was selected as the best performing Romanian company in a ranking made by the Romanian Centre for Economic Modelling (CERME) – according to an article published by *Adevarul* (19 February 2004). As a proof of its not so bad status, by article 8.10 of the privatization contract, paragraphs 1 and 2, the buyer (OMV) agrees to pay to the seller (the state) the unpaid dividends for years prior to 2003 (RON 192.3 billion, representing EUR 51.2 million at the 2003 average exchange rate) and for the year 2003 (RON 102.1 billion, representing EUR 27.2 million). This means that, at the time of its privatization, the Romanian state was entitled to

¹¹ EBRD press release, 14 December 2004; <http://www.ebrd.com/new/pressrel/2004/198dec14.htm>.

dividends of close to EUR 80 million which it receives in five annual instalments. These conditions were known by the seller and the potential buyer. Still it proved impossible to receive more than the EUR 1.5 billion offered by OMV for the 51% share package under the complex external and internal circumstances at the time of privatization.

There were also supporters of the deal, and they were in the majority, who recognized what this privatization meant in the process of EU accession and to economic transformation. 'By the OMV acquisition an entire history comes to an end as the company enters a new era, expected to be a market economy one, inclined to cope with competition challenges and no longer by facing various circles of interests. As one could note, PM Nastase noted this issue on the occasion of the signing of the contract ceremony. By becoming private, bought by the Austrian company OMV, various games of the interest circles come to an end, while on the other hand it is a big blow to corruption linked to the biggest Romanian state-owned company. Even analysts conclude that in the new 'format' Petrom will be part of the business environment improvement process through proper management and business discipline.'¹²

According to another analyst (Daianu, 2006)¹³, 'the reasons for Petrom's privatization had been to stop the activity of parasitic firms draining its resources and to introduce a well-performing management, and also the then eagerness to conclude EU accession'. Daianu, however, goes on writing that 'even these advantages of privatization cannot justify the way the privatization was done, including the disadvantageous conditions' (author's translation). Then he presents political arguments why high and increasing oil prices could have been foreseen. At this point we arrive at the current debate about the conditions set in the privatization treaty.

5 Controversial aspects of the Petrom privatization treaty in the 2006 discussion

In this chapter we summarize the main controversial aspects related to the OMV–Petrom privatization contract, as presented and discussed in the Romanian media.

Selling price and evaluation method

As no outsider is in the position to reproduce the 2004 evaluation of Petrom, nor correctly to estimate its present value, press reports in Romania rely on less professional estimations based on stock prices, oil price forecasts and the value of individual assets.

The purchase price per share (EUR 0.0525) was within the range of the stock market price for Petrom in the last semester prior to signing the privatization deal (0.034 in January

¹² Victor Lupu in *Nine O'Clock*, 24 July 2004, 'Consequences of the privatization of the year'.

¹³ Daniel Daianu in *Ziarul Financiare*, 11 December 2006, 'Era previzibila cresterea pretului titeiului?'.

2004 and 0.0564 in June 2004). However, the volumes traded on the stock exchange were very limited, at least prior to privatization; they could have given only a hint on the price, but not a clear price indication for the value of a large stock. The market price for Petrom shares is three times higher in January 2007 (17.3 eurocents) than it was in June 2004 (see Figures 1 and 2 at the end of Chapter 6). This development may not only reflect the improved results under OMV management and the improved market conditions in Romania, but also an undershooting in the initial quotations.

Leaving the stock market price aside, as the low trading volumes are not making a market price, many consider these days that the evaluation report under-estimated the value of the company due to lower than justified oil prices when calculating the value of the oil reserves. *Evenimentul Zilei* (22 November 2006) and *Ziua* (17 November 2006) calculated the underestimation at EUR 1-1.5 billion. The consultants' evaluation report estimated the value of Petrom reserves with an oil price of USD 22-23 for 2003-2004 up to USD 27 for 2025.¹⁴ The evaluation report is not public, but its methods and results were published in the Romanian media. The oil price in the privatization contract was based on early 2003 evaluations from the Energy Information Administration (EIA, www.eia.doe.gov). In January 2004 the EIA already increased its estimations for the current year but not for the following ones., OMV accepted the figures of the evaluation report. The company has been of the opinion that nobody could have predicted the sudden price increase and lasting high prices for energy carriers.

There have been expert opinions supporting the view that the oil price rise could have been foreseen (Stephens, 2004; Lemieux, 2005; Daianu, 2006). They could have good grounds for that – the impact of the Iraq war, sub-optimal investments in exploration, and surging demand of China. But one of the standard sources of forecasts, the International Energy Agency (IEA), was of a different opinion: in 2002 they wrote that 'crude oil prices are assumed to remain flat until 2010 at around \$21 per barrel (in year 2000 dollars)' (IEA, 2002); two years later, when prices were at 50 dollars, they wrote: 'we assume in our Reference Scenario that the prices in mid-2004 are unsustainable and the market fundamentals will drive them down in the next two years' (IEA, 2004). But seeing uncertainties around, the IEA also developed a high-price scenario with USD 35/barrel. One year later this level became the baseline until 2010 (IEA, 2005). Also the US government Energy Information Administration forecasted declining oil prices both in 2003 and in 2004 for the following two years (EIA, 2003; EIA, 2004). The quoted sources confirm that, although some experts did forecast higher oil prices, the prevailing official opinion was different.

¹⁴ Oil price forecasts are published in fixed USD terms thus current prices have to be corrected for a proper comparison. The 2025 forecast of EIA in nominal USD was 52 dollar per barrel. (EIA, 2004, p. 2.)

A further argument maintains that the selling price of Petrom, based upon the evaluation report, seems low also when regarding the current profits of Petrom. Petrom's EBIT in the first nine months of 2006 was EUR 628 million, close to the sum OMV paid to the Romanian state to acquire the 33.34% stake in 2004. Leaving aside market conditions, better management, etc., such a recovery rate is very unusual. *Ziarul Financiar* (14 November 2006) estimates the current market value of Petrom at EUR 8.75 billion. The same newspaper also looked at the asset value of parts of Petrom and found that in 2006 OMV sold six Petrom oil platforms in the Black Sea for EUR 100 million, a sum out of proportion as compared to the sum OMV paid for Petrom in 2004. Indeed, all oil companies in the world make high profits based on the unexpectedly high oil prices. This should be good news for their shareholders, including the Romanian government. Companies are also well advised if they invest profits into exploration and production as it is done at least in part by Petrom.

Another line of argument maintains that Petrom has been very important for OMV by its size and due to its reserves. In 2005, Petrom accounted for 64.2% of total OMV oil equivalent production, 72.5% of total OMV oil equivalent reserves and 88% of total OMV employees. Such large shares of OMV total production and reserves show that Petrom made a large contribution to OMV worldwide activities, from the very first year after acquisition. This might suggest that the value of Petrom for OMV was higher than the price paid. A commentator even suggested that Petrom should have taken over OMV due to its superior size.¹⁵ But size by oil production or employment is not market power (the turnover of OMV was about four times higher than that of Petrom in 2004) and does not reveal the ability to run an international company efficiently.

It is obvious that the arguments maintaining a cheap sell-out of Petrom are based on late 2006 conditions. Certainly, the price of the company would be much higher if privatized under present conditions due to increased profitability, higher international oil prices and lower investment risk attributed to Romania. This is an a-historic approach – the sales price can only be judged under the conditions available at the time of sale. If Petrom's reserves had really been undervalued, this should have attracted more investors with higher price offers, which was not the case. It is common truth that the value of a company or asset is what the buyer is willing to pay for it. At the time of privatization OMV gave by far the best offer, in fact it was the only among the three shortlisted companies which was ready to take the risk of buying Petrom as a whole. It is also important that sales price and capital increase are two separate items. The sales price was a government revenue and was financing long-term investment projects as reducing government debt has been no urgency in Romania (public debt to GDP is around 20%). As to the capital increase, OMV

¹⁵ Radu Tudor, 'Privatizations under wraps', *Nine O'Clock*, 24 April 2006.

has the contractual obligation to invest the money in Petrom modernization, which it has done.

Concession rights and royalties

Article 4.2.4(ii) in the privatization contract and article 15(1) in the Law 555/2004 stipulate that the level, the basis and the calculation modality of royalties will be maintained until 2014 (for ten years). The level, basis and calculation modality are described in Annex Y, article 10 of the contract as shares of the value of total production. These shares vary, for both oil and gas (depending on the production capacity of each operation site), between 3.5% and 13.5%. The ten-year fixed level of royalties was heavily challenged by media, analysts and politicians. Requests for re-negotiating it were voiced, but this is unlikely to happen unless DG Competition were to consider that a long-term fixed level of royalties represents an abuse of dominant power.

It is highly unlikely that the EU Commission would interfere because long-term fixed royalties are quite common in the international oil and gas business, reflecting the fact that investing in exploration and production need long-term calculation. The present royalty rates were introduced in Romania in 1998 and just taken over after privatization. They were lowered at that time to support the exploration activities of oil and gas companies. Petrom has recently prepared an international comparison of royalties which does not prove that Romanian rates would be particularly low. As compared to the Romanian royalty rates for oil, those rates are similar in Hungary, lower in Italy and higher in Austria. The average royalty paid in 2005 was 6% on the gas revenues and 12% on the oil revenues (Petrom Annual Report). The same percentages of revenue earn more for the government budget in nominal terms when the revenues of Petrom increase. Had the government applied the import prices to the domestically produced gas, its royalty income would increase.

Still, the royalty issue seems to be the only point in the current debate which may effectively be used to put pressure on OMV. There have been various discussions between the investor and the Romanian government to tap the Petrom revenues gained by higher gas prices and contribute to a Social Fund which would subsidize prices for the population (see Chapter 7 on gas prices).

Penalties

The privatization contract stipulates a large discrepancy between the amount of penalties that the two parties would have to pay if the contract were breached: while OMV is subject to a maximum penalty of 20% of the selling price (which means EUR 134 million), the Romanian state is subject to a maximum penalty equal to the selling price plus the subscription price (around EUR 1.5 billion). (See article 6.2.2 of the contract for the

maximum penalty of OMV, and article 6.3.5 of the contract for the maximum penalty of the state.) Reference can be made in this context to many other privatization contracts in Romania with clauses where the state was entitled to terminate the contract unilaterally if the buyer did not fulfil the investment obligations.¹⁶ In fact OMV was treated differently, but also the investor treated its newly acquired subsidiary differently by investing continuously and making Petrom into a regional headquarters. Based on the two and a half year track record of the investor and its obligations to the shareholders including the Romanian government, there is no practical reason for penalties.

Tax debts written off and budgetary credit for environmental damages

Article 4.2.4(i) of the privatization contract and article 11 of Law 555 stipulated that all unpaid taxes, contributions and other unpaid budgetary obligations accumulated until the end of 2003 and all their respective penalties and interests accumulated by 8 April 2004 were written off. Using data from Petrom's financial balance at end-2003, these tax debts amounted to EUR 185.04 million. Although also challenged in the press, write-offs were quite common in the privatization procedure (see Chapter 3 on privatization). The usual scheme was a debt-equity swap at a discounted rate but the write-off was also not without precedence (see Chapter 3). According to the 2004 Annual Report of the Romanian Competition Council, 'the annulment of fiscal debts that Petrom did not pay does not constitute state aid, since this provision was part of the package offered to any potential investor'. In general, debts can be worked out either by the state, which thus gets a sales price for the clean company, or the debts can remain in the company, in which case the buyer would offer a lower price. It cannot be decided *ex post* which of the two solutions would have earned more for the state, but it is certain that the price paid for the company with no fiscal obligations was higher than it would have been if it had carried past debt.

Article 10 of Annex P and article 20 of Law 555/2004 set the obligation of the Ministry of Finance to include for the next 14 years (after 2004) an annual EUR 50 million budgetary credit in the state budget to compensate OMV for potential losses from environmental damages up to the date of privatization. Local analysts consider this a highly uncommon practice.¹⁷ In some respects, the issues of past debt and past pollution are identical: related costs can be traded against the price of the company. The difference is that environmental damages are non-transferable, they have to be cleaned up one time. Petrom will get the reparation costs refunded from the state when it carries out such investments. There is no sign of such budgetary transfers in the 2005 and three-quarter 2006 Petrom reports, implying that the company has not made use of these funds.

¹⁶ Famous cases of cancelled contract were the privatization of Resita steels to Noble Ventures, USA, the privatization of Teopro Iasi to a Czech investor, and the privatization of ARO Campulung to an American investor.

¹⁷ Liviu Voinea in *Gardianul*, 17 November 2006.

Concluding remarks on the Petrom contract

It is a widely shared belief in Romania that the sales price was too low and the state has also lost on royalties and tax credit. The Ministry of Economy and Trade, the Ministry of Finance, even the Competition Council were allegedly too eager to privatize Petrom under any circumstances, even if the above-mentioned provisions created a disadvantage to the seller.

As to our knowledge, the speed and the terms of privatization were both in line with the circumstances in late 2003/early 2004 (see Chapter 4 on the Petrom privatization). Even a well-informed local analyst declared that ‘there are controversial aspects of the contract, but this does not mean that OMV should be blamed for bad things that happen in Romania’.¹⁸

6 Performance of Petrom after privatization

To assess the impact of privatization is difficult due to the absence of counterfactual evidence. A frequently adopted method is to compare the financial results of privatized and non-privatized companies in the same sector – but this cannot be applied in concentrated sectors where the privatization affected the main company with no remaining state-owned counterpart. The same methods and difficulties emerge when different forms of privatization should be compared. But comparing companies with foreign ownership and domestically owned companies confirms the superiority of the performance of foreign companies (Hunya, 2004). Domestic companies in less developed transition economies usually lack the means and the skills to restructure and grow. The most they can achieve is a defensive adaptation, i.e. decreasing output and employment while maintaining financial soundness. The ability to grow is usually connected with new investments and market access skills that are not available for domestic owners. A strategic foreign investor may have these skills and manage the recovery of former state-owned companies (Hunya, 2002).

The post-privatization results of Petrom which posed problems in the public opinion in recent months were related to declining output and employment as well as to the investments in buying petrol stations that may drain resources for exploration. There has been no doubt that the financial standing of the company has improved.

¹⁸ Op. cit.

Production cuts

In 2005 Petrom produced less oil and less natural gas than in 2004. This trend intensified in 2006: in the first nine months, oil production decreased by 8.5% compared to the same period of 2005, and natural gas production decreased by 5%. People believe that the production cuts contributed to the higher consumer prices of petrol and natural gas. The OMV argues that the (insignificant) output decline was caused by the ageing of some fields, but that due to new explorations production will stabilize in 2007.

Table 7

Petrom overview, in RON million

	2002	2003	2004	2005	2006
Turnover	7272	7135	8688	10760	13078
Net profit	228	144	-974	1416	2285
EBIT	.	458	-581	1884	2777
EBITDA	.	1011	114	2775	3596
Investments	1219	982	1303	1117	2937
Employees, end of period	60459	56694	50010	43546	32837
Crude oil, million tons	5.81	5.65	5.46	5.21	4.9
Natural gas, billion m ³	6.06	6.13	6.44	6.19	6.0

Source: Communication of Petrom.

Investments

Investments by Petrom were lower in 2003 than the previous year, picked up in 2004 but declined again slightly in 2005 (Table 8). In exploration and production, only EUR 146 million was invested in 2005. The Business Plan in Annex D of the privatization contract targeted higher values for this line of business (EUR 220 million in 2005). The contract also required Petrom to invest the funds gained by the capital increase in exploration, production and refining. This target was fulfilled in 2006 when the financial situation of the company improved significantly and investments increased 2.7-fold compared to the previous year.

Of the EUR 833 million investment outlays in 2006, exploration and production received an increasing share. Refining and marketing had a lower share but much higher amounts than in the year before. As part of the marketing investments Petrom bought the OMV refining and marketing subsidiaries (mainly petrol stations) in Romania, Bulgaria and Serbia. The value of the transaction was EUR 234.4 million (OMV press release of 17 January 2007). There have been voices in Romania accusing OMV of transfer pricing despite the fact that the valuation of the companies was done by the independent consultant KPMG. A new category in the Petrom investment report is 'corporate' with a growing share. This covers administrative investments, information technology and a new office building.

The company plans to maintain the 2006 investment level in the coming years. Total investment outlays should reach EUR 3 billion in the period 2006 to 2010. (For the investment plans of Petrom see Box 2.)

Table 8

	Investments by Petrom				
	2002	2003	2004	2005	2006
Total in RON million	1219	982	1303	1117	2937
Total in EUR million	390	261	321	308	833
Of which in %					
Exploration & production (E&P)	66.8	63.1	51.4	42.1	45.5
Refining and Marketing (R&M)	33.2	36.9	48.0	52.4	44.2
Chemicals (Doljchim)	.	.	0.6	0.3	0.2
Corporate	.	.	in E&P	5.2	10.1

Source: Communication of Petrom, EUR figures own calculation using average RON/EUR exchange rate.

Employment cuts

The number of employees, which is not clearly set in the privatization contract, has decreased from 50 thousand in 2004 to 33 thousands in 2006 (Table 7). More than 6 thousand jobs were lost in the exploration and production sector alone. This is a sensitive matter also because of the much delayed sale of an 8% stake of Petrom to the employees – employees at what date will benefit?¹⁹

Layoffs have taken place with no social conflict at Petrom. This is partly due to the generally good labour market situation in Romania, characterized by stable employment and falling unemployment. Another reason is that about one third of the released workforce was employed in outsourced activities where they were ensured to keep their jobs for another three years and also received half of the severance payments due at layoffs. Severance payments in Romania are about one year's salary in the case of mass-scale layoffs, which is quite an attractive sum. Early retirement has been another widely used scheme for older workers. For the released workforce Petrom offered career counselling and retraining (source: communication of Petrom).

Taxes and royalties paid to the state

The Romanian press rarely discusses the government revenues gained from Petrom; positive developments do not fit into the general feature it provides. The total taxes paid by Petrom to the government budget increased by 24.3% in 2005 as compared to 2004, amounting to EUR 1270 million (Petrom Annual Report 2005), of which the major part

¹⁹ The League of Oil Pensioners from Romania sued the government because Petrom pensioners do not have the right to acquire shares in the company. (*Nine O'Clock*, 13 February 2007.)

represented employment-related taxes and contributions; EUR 110 million was paid as corporate income tax and EUR 140 million represented royalties (25% more than in 2004). Tax amounts increased in 2006 by 13.3% in RON terms and 16.5% in EUR terms to EUR 1480.5 million. In this sum royalties constituted EUR 157.5 million. The state has also received its proportional share in the 14% increase of shareholders' equity value in 2005.

Box 2

Petrom's strategy for 2010

On 17 October 2006, the Petrom Board of Directors reconfirmed the development strategy for 2010. The overall strategic goal is to become the leading integrated oil and gas company in Southeastern Europe, thus positioning Petrom as an OMV hub for the region.

In *Exploration & Production*, significant investments together with a comprehensive transformation programme are expected to lead to a production stabilization in Romania at 210,000 boe/day, an increase of international production (mainly Kazakhstan) to 70,000 boe/day, a reduction of production costs to USD 9/boe as well as a reserve replacement ratio of 70%. Petrom will pursue the further growth of E&P activities in the Caspian area and Russia, the core areas for the development of upstream operations outside Romania.

In *Refining*, the strategy is based on a reconfiguration of the refineries which will benefit from large investment programmes in order to improve efficiency and to comply with EU product standards. Petrom will invest EUR 1 billion in Petrobrazi until 2011 and the capacity will be expanded from 4.5 mn tons/year to 6 mn tons/year. The refinery will target a 94% capacity utilization while the diesel output should increase three-fold to 2.1 mn tons in line with market demand. In Arpechim, investments will be directed at improvements in energy efficiency and product yield.

Petrom is to remain the *market leader* in Romania where it aims to reach a 35% market share, by further increasing the number of the flagship PetromV filling stations as well as by providing enhanced services and products. The international growth of the company is also reflected by the objective of expanding the retail network in Southeastern Europe and the Black Sea region.

The *gas business* will further develop at the same time with the expected liberalization of the market. The company intends to invest in the gas and electricity generation business as well as clean energy and is considering a future diversification of its activities in the power sector.

In light of the EU accession of Romania, the strategy includes specific actions allowing the company to comply with the requirements regarding *biofuels* and carbon management.

(based on Petrom press release, 18 October 2006)

Figure 1

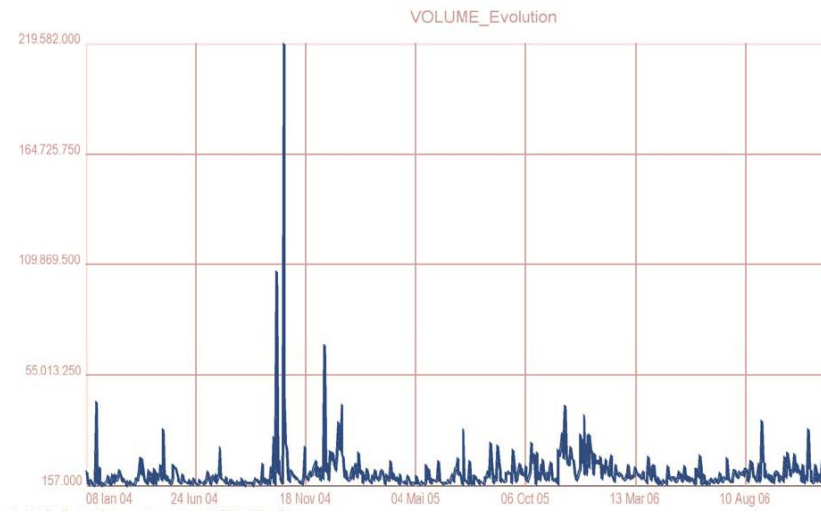
Evolution of Petrom share prices on the Bucharest Stock Exchange



Source: www.bvb.ro.

Figure 2

Evolution of Petrom trading volumes on the Bucharest Stock Exchange



Source: www.bvb.ro.

7 How to make gas prices affordable for the population?

This section seeks to shed some light on the Romanian debate about natural gas prices in view of existing practices in other EU member states. In particular, one item of interest for the Romanian authorities is the extent to which domestic consumers, for example low-income households, may be shielded against sharp rises in energy expenditure. Regulations at the Union level stipulate that gas prices for domestic consumption and for imports should be equalized. This is designed to ensure that member states do not grant subsidized energy prices to domestic consumers in general, or to certain specific categories of domestic consumers in particular.

As pointed out in Chapter 2, about 70% of gas consumed in Romania is produced domestically, the price of which is much lower, currently at about 45% of the price of gas imported to Romania from Russia. This is a major advantage enjoyed by Romanian industrial and household consumers. By low gas prices, industrial producers gain a competitive advantage over other countries which rely on imported gas only. An international comparison (Table 9) confirms that gas prices in Romania are among the lowest in the EU, both for households and for industry.

Table 9

**Price of natural gas for households and for industrial consumers,
EUR per Gigajoule (GCV), average 2005**

	Households, incl. taxes, nominal	Households, incl. taxes, at PPS	Industry, without VAT
EU-25	11.4	...	6.5
Austria	13.4	12.1	8.2
Czech Republic	7.5	12.4	5.1
Estonia	4.6	7.5	2.8
France	10.6	9.6	6.4
Germany	13.6	12.0	8.9
Hungary	6.2	9.8	6.0
Poland	7.6	13.5	5.3
United Kingdom	6.9	6.2	6.1
Bulgaria	6.7	17.4	3.8
Romania	4.8	10.3	3.7

Source: Eurostat, Gas and electricity market statistics, 2005.

The existing government programme foresees to complete price liberalization and the unification of domestic and imported gas prices by the end of 2008 as stipulated in the EU accession treaty. This will mean that the present indirect subsidy and competitive advantage enjoyed by industrial consumers will come to an end. A major question of industrial policy is, at what speed will prices be increased? The government is yet undecided.

There are at least three possible scenarios for finalizing the gas price adjustment:

- (1) Sudden increase in internal prices, closing the existing gap between import prices and internal prices.
 - (a) The advantage would be on the side of the natural gas producers (Petrom and Romgaz), which will no longer be forced to sell their production at low prices on the domestic market.
 - (b) The major disadvantage is that the Romanian energy-intensive firms will be suddenly hit, and they may not be able to cope with the competitive pressure from the outside, mainly EU producers.
- (2) A gradual increase in prices, at every 6 or 12 months, pre-announced by the regulatory authority, raising prices from a level of EUR 125 per 1000 cm at the beginning of 2007 to EUR 260 forecast for the end of 2008.
- (3) A very slow initial increase in prices in 2007, followed by a sudden shock at the end of 2008 – also hoping that international prices will come down by that time, thus mitigating the overall shock.
 - (a) This scenario would enable companies in chemicals and metallurgy to finalize their current investment programmes which aim at the fulfilment of EU environmental standards and introduce less energy-consuming technologies.
 - (b) It would maintain the current price-related subsidy system for many enterprises and postpone the price rises for the population.

Opinions differ in Romania as to which strategy to follow. In our opinion, only a clear track of price adjustment can have the necessary disciplining effect on companies. The problem therefore is the credibility of the government if it sets a gradual price adjustment strategy. Option 3 is thus not recommended. Option 1 would rule out policy risk and solve the problem for good. Option 2 could be feasible if the timetable of the price adjustment is agreed with the EU Commission and anchored in the post-accession monitoring process.

A separate issue is the gas price for households and district heating. Here one needs to take into account the low purchasing power of Romanian consumers who need affordable heating. The present quasi-subsidization through low-cost domestic gas will expire and the government budget has to make subsidies explicit. The government is not keen on finding alternatives to price-based subsidization. But they want to find funds for keeping the price for households at the current or even at a lower level also when world market prices will apply. There is a discussion about setting up a social fund and OMV has been called upon to contribute. But other details are vague and a state commission is to investigate the matter.²⁰

²⁰ *Nine O'Clock*, 10 January 2007, 'Gov't okays energy sector social fund negotiation commission'.

Household energy subsidies in the United Kingdom

The UK's policies can be divided into two categories. The first includes social policies run by the Department for Work and Pensions (DWP), which deals with social benefits. The second includes policies that tackle the problem of fuel poverty indirectly by seeking to improve the energy efficiency of households. Such policies are simultaneously designed to help the UK comply with EC Directive 2002/91/EC on the energy performance of buildings, and are thus as much environmental policies as they are social policies. As part of the first category of policies, DWP administers the *Winter Fuel Payment*, which is a yearly, tax-deductible, non-means-tested benefit paid in cash to residents above the age of 60. The payment is between GBP 100 and GBP 300 per person depending on circumstances, but regardless of income. The motivation for the policy is that senior citizens have been identified as being particularly at risk of fuel poverty. The main policy belonging to the second category is called *Warm Front*. It is administered by the Department for Environment, Food and Rural Affairs (DEFRA). It is a system of grants (up to GBP 2700 per household in the standard case) that are disbursed in kind to eligible households on a one-off basis. Eligibility is based on existing social benefit registers. Eligible households are checked by an engineer who assesses what steps to take to improve fuel efficiency, e.g. replacing an old boiler or improving insulation. The necessary changes are paid by using the grant money.

(Source: Authorities quoted in the text; compiled by Edward Christie, wiiw research economist.)

Household gas price subsidies in Hungary

Domestic gas prices in Hungary are calculated in line with the world market prices, taking the arithmetic average of light heating oil and diesel oil in dollar terms of the last three quarters prior to the period concerned. Domestically produced fuel is sold at the thus defined price to the consumer, but the budget skims the related profit of the gas company in the form of a mining tax. This revenue was thought to constitute the fund for subsidizing household consumption of gas. (There are about 4 million households in Hungary, of which 3.1 million are consumers of natural gas.) The system applied between October 2003 and December 2006 provided large subsidies up to the first 1500 cm consumption per household, less and less for further two categories of consumption. Gas prices were kept flat for almost three years, although the mining tax covered an ever decreasing part of the subsidies while an increasing part was paid from the government budget. Two changes in 2006 increased the price of gas for households without changing the system of subsidization: prices were increased by 30% as of 1 August for all consumption categories, and the applicable VAT rate was increased from 15% to 20% as of 1 September. But these measures did not prove to be enough to satisfy the needs of the budget consolidation programme and the government decided to radically change the subsidy scheme as of 1 January 2007. In the new regime, households principally pay the full gas price, but those with low income may claim partial compensation. The rate of compensation applicable for individual households has been designed according to their level of income. Lowest-income households receive the highest compensation. This system, while satisfying the principle that social policy targets only the needy, may be difficult to operate in a country where income statements are not very reliable and has also provoked dissatisfaction of the population.

(Source: Hungarian Energy Authority, www.eh.gov.hu and press reports compiled by the author and by Sándor Richter, wiiw research economist.)

One could imagine a system where the royalty income of the government budget paid by Petrom and by Romgaz, which would increase when gas prices are unified, constitutes the fund for household subsidies. Some other ideas may be provided by international experience, see Box 3.

Conclusions

Privatization in general was a necessary precondition for transforming Romania into a market economy. In 2003-2004 the privatization of large companies was seen as a prerequisite to put an end to non-transparent subsidization, rent-seeking and favouritism in the Romania economy. The Petrom sale was urged by the necessity to obtain from the EU Commission the 'functioning market economy status' and to close all negotiation chapters by the end of 2004. Although Petrom was not among the main loss-makers, its operations were not transparent enough and its future development required better corporate governance, capital investments and international networking.

The privatization process of Petrom and its outcome enjoyed broad support by international institutions. The World Bank and the EU provided financial funds, the EBRD appeared as a small investor to back the process. Fair and open bidding resulted in choosing the winner and setting the sales price. The conditions of privatization, the sales price and other stipulations of the privatization process reflected the then level of knowledge and risks associated with a Romanian company. The government chose the best offer available on the market at that time.

Due to higher oil prices and the improved standing of both Romania and Petrom, the value of the company is by now certainly higher. This is not without benefit to the state as the Romanian government and the Property Fund together own 40% of the company shares. The government has thus insight and influence on board decisions. It also benefits from the company's value increase and from shareholders' dividends.

The 2006 international oil price jump was not foreseen in 2003 by the Energy Information Association and the International Energy Agency. Also the price peak reached in 2006 does not seem lasting. Important is that the large one-time profit due to exceptionally high oil prices will finance investments. Petrom's investments have increased indeed and will reach much higher levels in the coming years than expected earlier. Although a large part of Petrom's 2006 investments was spent on acquiring OMV petrol stations in Romania and neighbouring countries, in the following years more will be spent on exploration and production.

The royalty rate Petrom pays on production has been inherited from before privatization and fixed for another ten years. Set in percentages of revenues, the state earns more on royalties when oil prices increase. An international comparison reveals that Romanian

rates are not particularly low and that fixing royalty rates for a longer period of time is standard practice. Had the government applied the import prices to the domestically produced gas, its royalty income would increase.

The sale of Petrom to OMV and its subsequent restructuring stabilized the company. New management techniques and organizational structures have increased efficiency and profitability. New exploration and other technologies are gradually implemented. The company plans that the production decline will come to an end in 2007 and explorations in Kazakhstan will add to Romania's supply in the future.

Petrom has gained new development perspectives in the international context. It is the OMV subsidiary in charge of the company's business in the CIS and in Southeast Europe. Bucharest has thus become the regional headquarters for an important European oil and gas company.

Applying import prices to domestically produced oil and gas is a European Union directive in order to avoid market distortions. Price unification is unavoidable also in Romania. But EU member countries have the freedom to support poor private households through means from the government budget. Social policy can be necessary but it must be a transparent part of the government budget. By applying unified gas prices, the government would earn more royalties and could use oil and gas royalty income to support the consumption of the needy part of the population.

Foreign direct investors may be unhappy about the way the current government and the Romanian press discuss the OMV–Petrom case. This has almost no relevance for greenfield investments, but it may delay large-scale privatizations especially in the energy sector. Privatization contracts were nullified in Romania in the past only due to severe non-performance of the investor and there has been no case of changing the main conditions of a privatization contract after a number of years. Thus no legal consequences for OMV or Petrom may arise.

Foreign investors have to realize the sensitivity of their actions in the fields of price management and social responsibility. The social and economic implications of price increases almost automatically turn into political issues. It is important to show social responsibility, to share part of the profits with the local community, and to better communicate problems and results.

The discussion around the OMV–Petrom case has given the current Romanian government the opportunity to stall a number of important privatizations. Maintaining state property in major companies prolongs political intervention in the economy and nurtures potential hotbeds of corruption.

Literature

- Calcagno, P., F. Hefner and M. Dan (2006), 'Restructuring before privatization – putting the cart before the horse: a case study of the steel industry in Romania', *The Quarterly Journal of Austrian Economics*, Vol. 9, No. 1, pp. 27-45.
- Comisia Nationala de Prognoza (2005), Calitatea activitatii societatilor comerciale in anul 2004; www.cnp.ro.
- Cosse, S. (2003), 'The Energy Sector Reform and Macroeconomic Adjustment in a Transition Economy: The Case of Romania', *IMF Policy Discussion Paper*, PDP/03/02, Washington DC.
- Daianu, D. (2006), 'Era previzibila cresterea pretului titeiului?', *Ziarul Financiare*, 11 December; http://www.zf.ro/articol_104754/daniel_daianu__era_previzibila_cresterea_pretului_titeiului_.html.
- Earle, J. and Á. Telegdy (1997), 'The Results of "Mass Privatization" in Romania: a First Empirical Study', Central European University, Budapest.
- EIA – Energy Information Association (2003), Annual Energy Outlook, Washington DC.
- EIA – Energy Information Association (2004), Annual Energy Outlook, Washington DC; [http://www.eia.doe.gov/oiaf/archive/aeo04/pdf/0383\(2004\).pdf](http://www.eia.doe.gov/oiaf/archive/aeo04/pdf/0383(2004).pdf)
- EU Commission (2002), Communication from the Commission to the Council and Parliament, Roadmaps for Bulgaria and Romania, COM (2002)624, November.
- European Commission, ECFIN (2004), Structural Challenges in Romania, ECFIN/130/04-EN, March.
- Government of Romania (2001), Report on the progress in preparing the accession to the European Union September 2000 – June 2001.
- Hunya, G. (1999), 'Romania: Stop-go Transformation 1990-2005', *wiiw Analytical Forecasts*, The Vienna Institute for International Economic Studies (wiiw), Vienna, August.
- Hunya, G. (2002), 'Restructuring Through FDI in Romanian Manufacturing', *Economic Systems*, Vol. 26, No. 4, pp. 387-394.
- Hunya, G. (2004), 'Manufacturing FDI in New EU Member States – Foreign Penetration and Location Shifts between 1998 and 2002', *wiiw Research Reports*, No. 311, The Vienna Institute for International Economic Studies (wiiw), Vienna, November.
- IEA – International Energy Agency (2002), World Energy Outlook 2002.
- IEA – International Energy Agency (2004), World Energy Outlook 2004.
- IEA – International Energy Agency (2006), Energy Balances of Non-OECD Countries, 2006 Edition, Paris.
- Lemieux, P. (2005), 'The Oil Price Mirage', 23 August; <http://www.mises.org/story/1892>.
- Lupu, V. (2004), 'Consequences of the privatization of the year', *Nine O'Clock*, 24 July.
- MEC, Ministry of Economy and Commerce (2006), Politica energetica a Romaniei in perioada 2006-2009. Energia sigura, accesibila si curate, pentru Romania, Bucharest.
- Ministry of Economy and Trade (2005), Industrial Policy of Romania 2005-2008, Bucharest, September.
- Ministry of Economy and Commerce (2006), Romanian Industry, June.
- Radu, P. C. (2005), 'The privatization of Romania's oil industry has enriched the well-connected – and corrupt'; <http://www.publicintegrity.org/oil/report.aspx?aid=598>.
- Romanian American Enterprise Fund (2004), 'Some lessons learned from privatization in the Romanian energy sector', *Romanian Business Digest*, Bucharest.

- Romanian Government (2001), Pre-accession Economic Programme.
- Romanian Government (2002), Pre-accession Economic Programme.
- Romanian Government (2003), Pre-accession Economic Programme.
- Romanian Government, Ministry of Economy and Commerce (2003) Road map for energy sector of Romania, Bucharest, July.
- Romanian Government (2004), Pre-Accession Economic Programme (2004); http://www.cnp.ro/en_PEP.html.
- Saadat, O. (2006), Romania: Romania's Challenge in the European Energy Crisis; <http://www.worldbank.org.ro/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/ROMANIAEXTN/0,,contentMDK:20925295~menuPK:50003484~pagePK:2865066~piPK:2865079~theSitePK:275154,00.htm>
- Serbanescu, I. (2006), 'Central and Eastern Europe adrift in political sea (II)', *Nine O'Clock*, 8 September.
- Serbanescu, I. (2007), 'CEC was not about the money!', *Nine O'Clock*, 17 January.
- Stevens, P. (2004), 'The Future Price Of Crude Oil', *Middle East Economic Survey*, Vol. XLVII, No. 37, 13 September; <http://www.mees.com/postedarticles/oped/a47n37d01.htm>
- Tudor, R. (2006), 'Privatizations under wraps', *Nine O'Clock*, 24 April.
- Voinea, L. (2003), 'Is relocation really good for the host economy? Evidence from the Romanian manufacturing industry', Paper read at the 2nd Euroframe Conference.
- World Bank (2005), Implementation completion report on a loan of US\$ 300 million to Romania for a second Private Sector Adjustment Loan, Report No. 32653.
- World Bank (2004), Romania: Restructuring for EU Integration – The Policy Agenda Country Economic Memorandum (In Two Volumes), Volume II: Main Report and Annexes, Report No. 29123-RO.

Short list of the most recent wiiw publications

(as of March 2007)

For current updates and summaries see also wiiw's website at www.wiiw.ac.at

Privatization Disputes in Romania – the Petrom Case

by Gábor Hunya

wiiw Research Reports, No. 337, March 2007

36 pages including 9 Tables and 2 Figures

hardcopy: EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 3/07

edited by Leon Podkaminer

- Net outward investment position of the new member states
- Sources of growth in the CIS
- The troubling economics and politics of the US trade deficit
- Selected monthly data on the economic situation in ten transition countries, 2005-2007
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, March 2007

36 pages including 17 Tables and 2 Figures

(exclusively for subscribers to the wiiw Service Package)

Rapid Growth in the CIS: Is It Sustainable?

by Garbis Iradian

wiiw Research Reports, No. 336, February 2007

81 pages including 24 Tables and 11 Figures

hardcopy: EUR 22.00 (PDF: EUR 20.00)

Private Consumption and Flourishing Exports Keep the Region on High Growth Track

by Vladimir Gligorov, Leon Podkaminer et al.

wiiw Research Reports, No. 335, February 2007

(special issue on economic prospects for Central, East and Southeast Europe; covering Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Hungary, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, Turkey, and China)

134 pages including 49 Tables and 19 Figures

hardcopy: EUR 70.00 (PDF: EUR 65.00)

The Vienna Institute Monthly Report 2/07

edited by Leon Podkaminer

- Regional convergence in the NMS
- EU membership – support and challenge to the competitiveness of the Polish and Romania economies
- The flawed logic of capital account liberalization
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, February 2007

36 pages including 21 Tables

(exclusively for subscribers to the wiiw Service Package)

The Consequences of WTO Accession for Belarus

by Kiryl Kurilionak, Stanislav Vassilevsky and Vitaly Medvedev

wiiw Research Reports, No. 334, January 2007

28 pages including 8 Tables

hardcopy: EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 1/07

edited by Leon Podkaminer

- Romania: EU entry and related environmental challenges
- China and India: a comparison of recent economic growth trajectories
- Poland's experience with capital account convertibility
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, January 2007

32 pages including 15 Tables and 2 Figures

(exclusively for subscribers to the wiiw Service Package)

Economic Growth, Regional Disparities and Employment in the EU-27

by Michael Landesmann and Roman Römisch

wiiw Research Reports, No. 333, December 2006

74 pages including 7 Tables, 47 Figures and 5 Maps

hardcopy: EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 12/06

edited by Leon Podkaminer

- Updated wiiw forecasts for 2006 and 2007
- Albania 1 euro
- Bosnia and Herzegovina: economy improving despite politics
- Kosovo: an emerging state
- Montenegro: the first year of independence
- Turkey: back on course (economically)
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, December 2006

28 pages including 15 Tables

(exclusively for subscribers to the wiiw Service Package)

Employment Developments in Central and Eastern Europe: Trends and Explanations

by Michael Landesmann and Hermine Vidovic

wiiw Research Reports, No. 332, November 2006

75 pages including 23 Tables and 27 Figures

hardcopy: EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 11/06

edited by Leon Podkaminer

- Russian Federation: growing economy, deteriorating politics
- Ukraine: the time of big business returns
- Croatia: record FDI inflow
- Serbia: still in search of stability
- Macedonia: speed-up of growth still elusive
- INDEUNIS: joint research project on transition, integration and restructuring in the New EU Member States and the Newly Independent States
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, November 2006

34 pages including 15 Tables

(exclusively for subscribers to the wiiw Service Package)

wiiw Handbook of Statistics 2006: Central, East and Southeast Europe

covers key economic data on Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, the Slovak Republic, Slovenia and Ukraine, 1990 to September 2006

wiiw, Vienna, November 2006, ISBN-13 978-3-85209-011-5 (ISBN-10 3-85209-011-3)

591 pages including 336 Tables and 105 Figures

hardcopy: EUR 92.00

CD-ROM (PDF): EUR 92.00; CD-ROM (MS Excel Tables + PDF) + hardcopy: EUR 230.00

Individual chapters (MS Excel Tables, on CD-ROM or via E-mail): EUR 37.00 per chapter

Ukraine: Current Economic Situation and Future Prospects

by Vasily Astrov

wiiw Research Reports, No. 331, October 2006

51 pages including 16 Tables and 7 Figures

hardcopy: EUR 22.00 (PDF: EUR 20.00)

Hungary, Slovakia and the Czech Republic: Longer-term Growth Prospects

by Leon Podkaminer and Robert Stehrer

wiiw Research Reports, No. 330, October 2006

(reprinted from: *New Regional Economics in Central European Economies: The Future of CENTROPE*, Proceedings of OeNB Workshops, No. 9, Oesterreichische Nationalbank – OeNB, Vienna, March 2006, pp. 120-145)

26 pages including 21 Tables and 2 Figures

hardcopy: EUR 8.00 (PDF: free download from wiiw's website)

Goodwin's Structural Economic Dynamics: Modelling Schumpeterian and Keynesian Insights

by Michael Landesmann and Robert Stehrer

wiiw Working Papers, No. 41, October 2006

26 pages including 5 Tables and 8 Figures

hardcopy: EUR 8.00 (PDF: free download from wiiw's website)

The Vienna Institute Monthly Report 10/06

edited by Leon Podkaminer

- The Czech Republic: high growth likely to slow down
- Hungary: convergence programme revised
- Poland: domestic demand strengthening further
- Slovakia: little change in economic policy, strong growth continues
- Slovenia: flat tax concept abandoned
- Bulgaria: pre-accession reform rush pays off
- Romania: persisting uncertainties at the doorstep of the EU
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, October 2006

36 pages including 18 Tables and 2 Figures

(exclusively for subscribers to the wiiw Service Package)

The Vienna Institute Monthly Report 8-9/06

edited by Leon Podkaminer

- Poland's competitive position in the enlarged EU
- Ownership structure and development of Russian firms
- Building walls: a note on immigration
- Selected monthly data on the economic situation in ten transition countries, 2005-2006
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, August/September 2006

34 pages including 19 Tables and 2 Figures

(exclusively for subscribers to the wiiw Service Package)

wiiw Service Package

The Vienna Institute offers to firms and institutions interested in unbiased and up-to-date information on Central, East and Southeast European markets a package of exclusive services and preferential access to its publications and research findings, on the basis of a subscription at an annual fee of EUR 2,000.

This subscription fee entitles to the following package of **Special Services**:

- A free invitation to the Vienna Institute's **Spring Seminar**, a whole-day event at the end of March, devoted to compelling topics in the economic transformation of the Central and East European region (for subscribers to the wiiw Service Package only).
- Copies of, or online access to, **The Vienna Institute Monthly Report**, a periodical consisting of timely articles summarizing and interpreting the latest economic developments in Central and Eastern Europe and the former Soviet Union. The statistical annex to each *Monthly Report* contains tables of the latest monthly country data. This periodical is not for sale, it can only be obtained in the framework of the wiiw Service Package.
- Free copies of the Institute's **Research Reports** (including *Reprints*), **Current Analyses and Country Profiles** and **Statistical Reports**.
- A free copy of the **wiiw Handbook of Statistics** (published in October/November each year and containing more than 400 tables and graphs on the economies of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Russia, Serbia and Montenegro, the Slovak Republic, Slovenia and Ukraine)
- Free online access to the **wiiw Monthly Database**, containing more than 1200 leading indicators monitoring the latest key economic developments in ten Central and East European countries.
- **Consulting**. The Vienna Institute is pleased to advise subscribers on questions concerning the East European economies or East-West economic relations if the required background research has already been undertaken by the Institute. We regret we have to charge extra for *ad hoc* research.
- Free access to the Institute's specialized economics library and documentation facilities.

Subscribers who wish to purchase wiiw data sets **on CD-ROM** or special publications not included in the wiiw Service Package are granted considerable **price reductions**.

**For detailed information about the wiiw Service Package
please visit wiiw's website at www.wiiw.ac.at**

To
The Vienna Institute
for International Economic Studies
Oppolzergasse 6
A-1010 Vienna

- ☐ Please forward more detailed information about the Vienna Institute's Service Package
- ☐ Please forward a complete list of the Vienna Institute's publications to the following address

Please enter me for

- ☐ 1 yearly subscription of *Research Reports* (including *Reprints*)
at a price of EUR 225.00 (within Austria), EUR 250.00 (Europe) and EUR 265.00 (overseas) respectively

Please forward

- ☐ the following issue of *Research Reports*
- ☐ the following issue of *Current Analyses and Country Profiles*
- ☐ the following issue of *Working Papers*
- ☐ the following issue of *Statistical Reports*
- ☐ the following issue of *Research Papers in German language*
- ☐ the following issue of *Industry Studies*
- ☐ the following issue of *Structural Reports*
- ☐ the following issue of *wiiw Database on Foreign Direct Investment*
- ☐ the following issue of *wiiw Handbook of Statistics*

.....
Name

.....
Address

.....
Telephone

Fax

E-mail

.....
Date

.....
Signature

Herausgeber, Verleger, Eigentümer und Hersteller:

Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),
Wien 1, Oppolzergasse 6

Postanschrift: A-1010 Wien, Oppolzergasse 6, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50

Internet Homepage: www.wiiw.ac.at

Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.

P.b.b. Verlagspostamt 1010 Wien