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THE POWERFUL NATURE – THE ROMANIAN FLOODS

After the devastations of the spring, the rain made horrible havocs in July again, and caused the biggest floods of the last decades in Romania. Since 1970 there was not so serious flood like this; from the 42 Romanian villages 34 was affected. This flood coincides with the government crisis, so it was not attended in time and in an organized way. The political interest was harder. Although, it was more than a serious situation. It was and it is a tragedy. The flood killed more than 20 people and left thousand others without a roof over their heads and caused huge damages. The water washed away works of lives.

Nevertheless, the flood was a great evidence for the inefficiency of the Romanian disaster recovery. It has no vehicles, boots and other equipments; if there is a necessity situation it borrows instruments from firms and public companies. The basis of the rescue and reconstruction is the army.

THE BACKGROUND AND THE REASONS

The questions: “Why had to die so many people? Why was the havoc so rough? And how could the rain make so serious damages in Romania?” could be understandably conceived for everybody. The answer on the first sight can be very unpoetic. It is doubtless that the nature was cruel in the last month, and streamed an unthinkable might rain to the country. But the rain is only the one thing, in “normal” circumstances it would not has to be enough to cause a so huge destruction and to kill. The main cause of the tragedy was the very disused and old dyke system, which need to be restored in the future.

Additionally the effects of floods were boosted by a series of artificial factors, such as incontinent deforestations of the last few years, the exploitations of the riverbeds and last but not least the outdated anti-disaster strategy.

Premier Calin Popescu-Tariceanu outlined that the people have to be act more environment-consciously, and referred to the strategy of fighting against disasters in Romania.

ROMANIA STAID NOT ALONE IN THE COMPLAINT

Heard about the incidences in Romania, the world did not desert the country. Following the first wave of floods in the western part of Romania the World Bank has agreed to make available an amount of 33 million USD to meet the immediate needs of reconstructing road and flood protection infrastructure. These resources combined with counterpart funding total to USD 51 million are allocated from the on-going Hazard Risk Mitigation and Emergency Preparedness and Transport Restructuring projects.

The British Red Cross provided GBP 100 000 to help victims of recent floods in Romania and in Serbia and Montenegro. Of the GBP 100 000 sent to the region, 40 000 were contributed by the UK Government towards the Romanian relief effort.

The European Union assisted Romania as well to recover from the severe floods. It has voiced readiness to assist Romania in solving the problems generated by floods, by granting funds needed for reconstructing the flood-stricken areas, both under the Solidarity European Fund, and under the Phare 2004 and 2005 programmes. Romania is to receive from the European Commission EUR 40 million under the ISPA programme, EUR 20 million under PHARE programme and EUR 70 million through SAPARD programme.

Pope Benedict XVI has donated USD 25 000 for flood victims of Moldavia. The money was paid into the accounts of the last Roman-Catholic Bishopric. According to a release of the Iasi Diocese, “The Vatican replied immediately and paid out the funds.”

The Government of Japan also decided to extend emergency assistance in kind (tents, water purifiers, generators), equivalent to about EUR 100 000 to the Government of Romania, which is sustaining a large-scale disaster from flood.

The Government of the Republic of Korea has decided to contribute USD 50 000 to the emergency relief funds to the Romanian Government. With this donation, the Korean aid for the Romanian floods relief this year reaches to USD 80 000, including USD 30 000 donated by the Government of Korea in May this year for the flood relief in Timis and Caras-Severin region.

Beyond the assistances from above, a lot of other countries have given a hand:

TABLE 1. – LIST OF COMMITMENTS/CONTRIBUTIONS AND PLEDGES AS OF 12-AUGUST-2005

Donor	Channel	Description	Commitments/ Contributions USD	Uncommitted Pledges USD
Czech Republic	Bilateral	9 sets power generators, 4,500 pieces personal packages*	0	0
Germany	THW	32 technicians, monitoring of situation and fact-finding mission*	0	0
Germany	THW	Transport cost for pumps, generators and water proof clothing; rehabilitation of drinking water fountains, pumping works - EUR 8,975	10,826	0
Germany	Caritas/DCV	Distribution of hygienic items and infant food parcels - EUR 35,000	42,219	0
Germany	RC/Romania	Distribution of sleeping bags - EUR 50,000	60,459	0
Hungary	Bilateral	21-man medical, rescue and water purification team, with necessary equipment*	0	0
International Federation of Red Cross and Red Crescent Societies	IFRC	Disaster Relief Emergency Fund - CHF 160,428	124,605	0
Luxembourg	Fondation Caritas Luxembourg	Food, shelter, kits - EUR 25,000	30,157	0
Poland	Bilateral	Water purification tablets, blankets, antibiotics and anti-diarrhoea medicines*	0	0
Switzerland	CARITAS	Rehabilitation of houses - CHF 110,000	85,271	0
United States of America	WV	Relief programs	600,000	0
Grand Total: USD			953,537	0

Pledge: a non-binding announcement of an intended contribution or allocation by the donor. ("Uncommitted pledge" on these tables indicates the balance of original pledges not yet committed.)

Commitment: creation of a legal, contractual obligation between the donor and recipient entity, specifying the amount to be contributed.

Contribution: the actual payment of funds or transfer of in-kind goods from the donor to the recipient entity.

Source: http://ocha.unog.ch/fts/reports/daily/ocha_R10_E14929___05081121.pdf

THE PRESENT AND THE FUTURE

Romania is a country of considerable potential: rich agricultural lands; diverse energy sources (coal, oil, natural gas, hydro, and nuclear); a substantial, if aging, industrial base encompassing almost the full range of manufacturing activities; an educated, well-trained work force; and opportunities for expanded development in tourism on the Black Sea and in the mountains. In the first semester of this year the country's economy advanced on a right way. The encashment to the budget for the first half of the year increased on the consolidated budget, in nominal terms, by 17,3%, compared with the same period of the last year.. In addition, the insurance budget for unemployment has increased in the same period by 18, 2%, and the revenues to the local budgets by 18,1%. Also, was consisted an increment of the revenues from the VAT of 27, 7%, namely RON 2.16 billions. In the first 5 months in 2005 the FDI to Romania increased with 12%, compared to the same period of the last year. The Prime Minister Calin Popescu-Tariceanu has appreciated the evolution of the economic indicators and he underlined that must be fulfill all the efforts to improve the collecting to the state budget.

But now floods hit the Romanian economy below the belt. The total material damages recorded so far in all sectors amount to RON 2.3 billions RON. National transportation has been severely affected by the floods as well. 17 national roads have been blocked by the waters in Moldova and Oltenia; trains are also restricted in several regions. Reconstruction of bridges is another sensitive issue, as destruction of some of them virtually blocked access to certain areas. Reconstruction of the railway infrastructure alone requires as much as EUR 60 million, which would have normally been enough to grade up the network across Romania. Before the floods the country set an aim for a 6% GDP growth rate for the year, but now, after the affairs, and therefore it could calculate "only" on 5.5% at best.

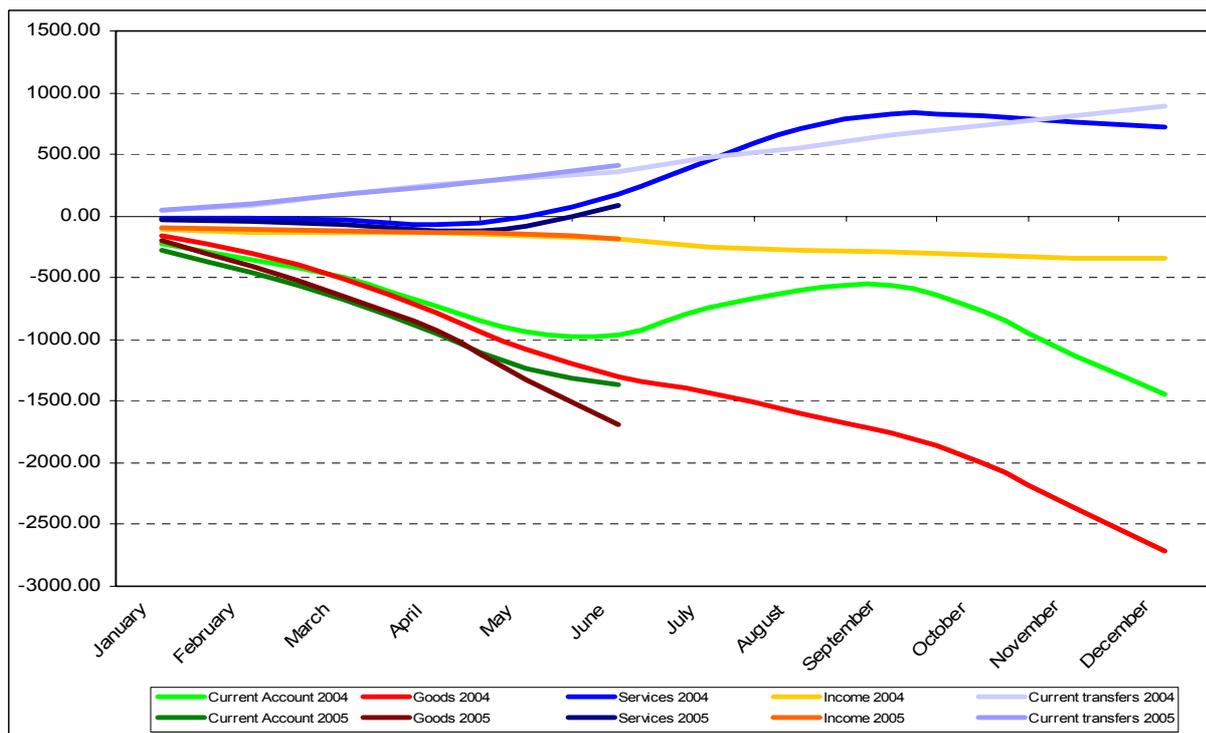
The Romanian National Bank will introduce the system of the direct and continuous inflation target, and want(ed) to achieve a 7% 12 month inflation target this year and 5% in 2006. The main tool in this system will be the price stability, and not the exchange rate of the RON. But after the affairs BNR Governor Mugur Isarescu said this year's floods would put pressure on inflation, which could exceed the new target. The rises in natural gas and utility tariffs announced for this year will reportedly be deferred for 2006. All the same, the central bank maintains the 5% inflation target for 2006. Furthermore the Government has decided on an increase of the 2005 budget deficit, accounting for one per cent of the GDP, especially for the emergency situation.

It is clear that the main objective of Romania is to be an EU-member in 2007; for all that this datum seems to be more and more seriously to achieve. Olli Rehn, the high commissioner of the enlargement of the European Union has obtained in July that Romania has no time to waste if it wants to join in 2007. Till then the Government has a lot of to do on the fields of the judiciary reforms, the elimination of the corruption, and the law-harmonization with the Union. Furthermore the commissioner gave utterance to his worries about the present, obscure situations in the internal affairs in Romania. The Commission publishes in October a denotation about how Romania advanced with the reforms, and if the country would not to make the necessary efforts and not to achieve the wanted steps, the accession will lie over to 2008. According Olli Rehn, the country's delay on the fields of reforms is now more months. The situation is just harder after the floods, when all of the efforts have to be focused on the damages. Romania could get more far from the EU, so it is not unlikely that the ideal accession datum for Romania will be the January 2008. In itself the floods were not to be enough to mess up the accession, but they render it more difficult in an anyway difficult situation, when Romania had a delay in the preparation process.

CURRENT ACCOUNT DEVELOPMENT: BIG PROBLEM AT FIRST GLANCE

In the first half of 2005 the current account deficit reached record value in Bulgaria. Between January and June current account deficit rose to EUR 1.37 billion; this is 14.5% of the estimated GDP in H1 2005. In the previous year C/A deficit remained under EUR 1 billion (EUR 962 million) so the balance worsened by 42.6% during that period of the year.

CHART 2. – EVOLUTION OF C/A BALANCE AND ITS COMPONENTS, 2004-2005 (MILLION EUROS)



Source: Bulgarian National Bank

The worsening of the current account balance is mainly due to the rising deficit in foreign trade. In the first six months trade deficit reached EUR 1.7 billion compared to EUR 1.3 billion in the same period of the previous year which is a 30% increase in nominal terms. In fact, the worsening foreign trade balance also characterised last year when trade deficit per GDP ratio jumped from 12.5% (2003) to 14% in 2004.

Actually, the growth rate of exports and imports were almost equal in the first half of the year. Export of goods increased by 21.2% in the first six months, while the same figure of import reached 23.6% in the same period. However, the large gap between the values of export (EUR 4381.7 million) and import (EUR 6588.8 million) resulted in the large expansion of trade deficit.

There are two major factors responsible for the worsening tendency of the trade balance. Firstly, due to the fact that Bulgaria is a significant energy importer, oil price hikes had a major impact on energy import value. Net balance worsened by 35% in case of SITC 3 category (mineral fuels, lubricants and related products) and as a result, balance worsened by approximately EUR 200 million because of the rising oil prices.

Secondly, import demand was boosted rather by investment than consumption. Import of capital goods increased more significantly than consumer goods due to the robust growth of investments. On the other hand, consumption growth also gained momentum and had a negative impact on the evolution of trade

balance. In the second half of the year, these factors are expected to continue, thus, the deficit is expected to increase to 16.5% of GDP or EUR 3.5 billion in current year.

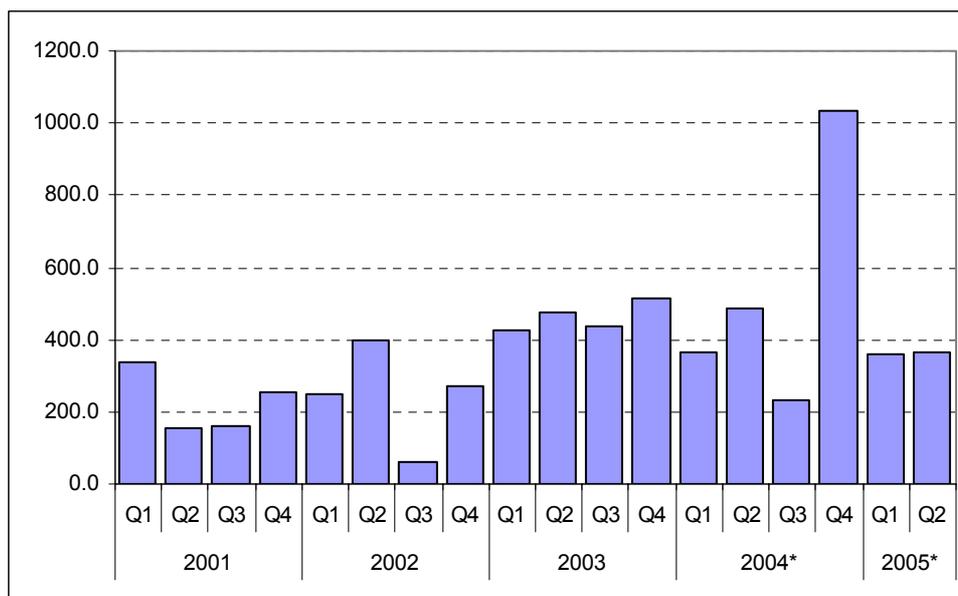
Regarding the balance of services, the tendency is similar to that of the last year in the first half of 2005. The balance was in deficit in the first five months and after that the balance turned to a surplus due to seasonal factors. From June to September, the balance of services is usually improving due to the massive amount of revenues from tourism sector. Accordingly, that sector has a major role in financing a significant part of the deficit cumulated in case of other components of the current account (such as foreign trade).

The other two main components played less important role in the evolution of current account. While the deficit of incomes balance decreased somewhat (by 2.9% or EUR 6.5 million) in the first six months of 2005, the surplus of current transfers balance increased by EUR 60.5 million or by 17.1%.

Considering the aforementioned factors and processes, current account deficit can reach EUR 1.9 billion which represents an approximately 30% increase of the deficit in nominal terms in 2005. It also means that the C/A deficit per GDP figure is expected to climb from 7.4% to 9%.

At first glance it seems a serious problem of the Bulgarian economy; however, it is also worthy to regard the financing side of the account. In last year when C/A deficit reached EUR 1.4 billion the value of net foreign direct investment was more than EUR 1.6 billion which was able to easily finance the massive deficit of the current account.

CHART 3. – DEVELOPMENT OF FDI (Q1 2001 – Q2 2005, MILLION EUROS)



Source: Bulgarian National Bank

In this year, net FDI is expected to reach or even exceed the 2004 level, thus, the C/A deficit will be financed again mainly by FDI in 2005. Accordingly, the huge foreign trade deficit and its consequence, the high C/A deficit seem to be a serious risk at the first look, in fact, in current shape of the economy, this issue is not a huge problem.

VAT INCREASE IN ROMANIA- A MAKESHIFT

Starting 1 January 2006 the Romanian Government intends to increase the VAT by 3 percentage points from 19% to 22%. With this step it wants to moderate the internal consumption and reduce the deficit of the state budget. The estimations of the Minister of Finance, Ionut Popescu show that the VAT increase would bring a plus to the state budget of some RON 3.5 billion. Although the possible VAT increase is a very vexed question in the Romanian Government, and it has been the subject of several public statements, the measure seems to be supported by most economical analysts. And it is not a negligible point of view that this step is not an intention in itself, but it must be analysed in connection with the commitments taken by Romania in the European accession process.

THE PAST

The most important economic measure taken by the new government was the introduction of a flat rate of 16% for corporate profit tax (replacing the 25%) and for personal income tax (replacing the progressive tax system with rates between 18% and 40%) starting 1 January 2005. The measure is expected to consolidate the foundations and mechanisms of the Romanian market economy, to support private entrepreneurship by creating a more favourable environment for investments and business in general, to boost employment and to simplify the fiscal procedures. The Government also increased the tax on micro-companies turnover from 1.5% to 3%.

The objectives of the Romanian tax reform in January were:

- enhancing and sustaining the economic growth,
- increasing the economic competitiveness
- higher net revenues for population and business sector,
- stimulating entrepreneurship, private investment and job creation,
- attracting more FDI inflows,
- supporting the development of the middle-class, and
- improving tax collection and reducing the gray economy.

Now, the Romanian flat tax system is one of the most liberal fiscal policies in Europe. It has proved to have a positive effect on Romanian salaries, which increased by 5.2% in January of 2005 in comparison to December 2004. It has brought in more revenues and helped to reduce registered unemployment by teasing business out of the shadow economy. In the first quarter of 2005 the number of employees rose by 153 000, which is almost double from the same period a year ago.

THE PRESENT

Romania is set to register in 2005 the biggest annual economic growth from among all Central and Eastern European countries, but also the highest inflation rate, according to a UniCredit survey. Country's GDP over 2005-2007 is expected to grow by EUR 10 billion annually. But there are problems with the state budget. Under the IMF's guidance, consolidated budget deficit has dropped significantly from earlier levels.

TABLE 2. – BUDGET DEFICIT IN % IF THE GDP IN ROMANIA

1999	2000	2001	2002	2003	2004
4.0%	3.7%	3.5%	2.6%	2.4%	1.2%

Source: <http://www.traveldocs.com/ro/economy.htm>

At the end of the first three months of 2005, the consolidated budget posted a surplus of 0.13% of GDP. At the end of this year, Romania is estimated to achieve consolidated budget deficit between 0.5% and 1% at most, according to how high the current account deficit will be at the end of this year. With this level of the deficit, the country can fulfil the Maastricht criteria with the limit of 3%. The problem is that although budget deficits have declined since 1999, government expenditures continue to outpace revenues. Without higher incomes to that, Romania will not be able to draw more European funds, where the co-financing is requested, Premier Tariceanu said. VAT increase could be the solution.

The higher VAT is the only tool that can do anything about the out-of-control current account deficit of Romania as well, because the alternative (discouraging credits for example) would be default on foreign payments, with the well-known effects on a sudden devaluation of the home currency and the explosion of internal prices.

Of course there is a strong opposition of this step as well. They say there are at least two reasons why the VAT increase should not take place:

- the effect it will have on society's most disadvantaged categories, and
- the discouraging effect on the business environment.

Furthermore it is a worry as well that this action endangers the country's aim to meet the inflation goals. But according to Popescu, BNR agrees with a higher VAT quota starting with the next year. The Minister of Finance admits that the representatives of the Central Bank are dissatisfied with the delay of adopting a decision, which makes it difficult to announce an inflation target for next year.

THE FUTURE

Tariceanu states that Romania recorded a large growth of the external deficits, and the current account deficit has increased by 60 per cent in the first half of 2005, compared to the first six months of 2004, although the budgetary policy cannot allow bigger deficits if Romania wants to achieve its main objective, namely the EU accession in 2007.

"A brief calculation shows that almost three per cent of GDP are needed as supplemental income at the horizon of the year 2007. Considering this perspective, the answer which can stand out is a possible increase of the taxation degree and, concurrently, definitely, a much better and more rigorous collection of the income to the budget," Tariceanu said.

The authorities will increase the degree of absorption of the EU funds as well, considering that the factor of absorption of the sums allocated ISPA projects, for instance, is around 12-14%.

But to this day the Tariceanu Cabinet has not considered such a modification of the consumption tax system. Any modification of this kind must be integrated in Romania's medium term strategy, and it cannot be operated without prior in-depth analysis and serious public policy debates. But without the VAT increase, the budget would not have resources allowing for the decrease in social security contributions. And furthermore it would be insistent to abolish this uncertain atmosphere, within the inflation target could not be appointed, and there are only news from debates about the VAT increase, which would influence the life of the whole population and foreign investors as well.

THE START OF THE IMPROVEMENT IN THE ALBANIAN ELECTRICITY SECTOR

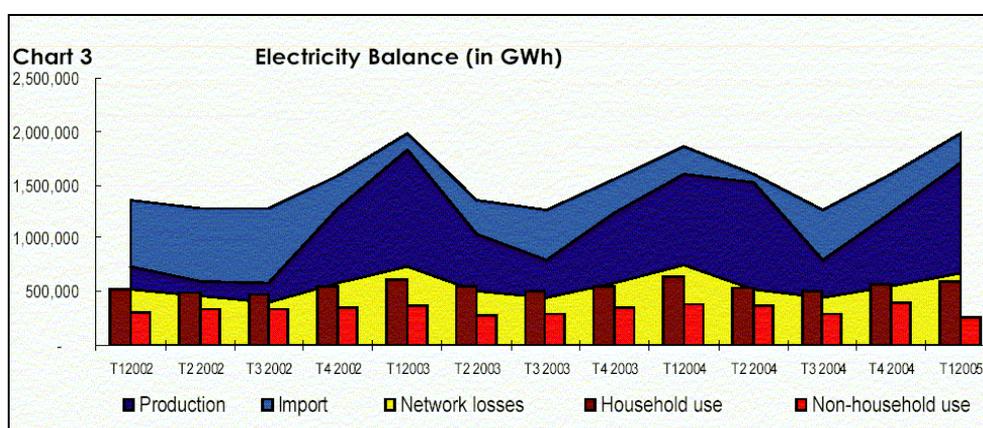
In the early 1990s, Albania was a net electricity exporter, with exports even up to 20% of the domestic generation. However, due to the neglect of maintenance, overloading and outdated equipment, some of the power plants, the transmission and distribution system were run down. Power outages became frequent. Moreover, due to the fact that even nowadays the hydro-electric stations produce 98-99% of the total production, the power system is vulnerable – depending on hydrological conditions (river flows). In 2002 domestic electricity production met only 50% of the demand, and recently the demand within the country is increasing. In the first quarter of 2005 the domestic electricity production increased by 6% compared to the same quarter in 2004. The Albanian economy's growth shows impressive figures, with real GDP growth around 6%. The performance of the energy sector ought to sustain this development.

THE RECENT SITUATION AND PROBLEMS

Recently the electricity sector is represented by the public sector – which consists of KESH (Albanian Power Corporation) and TSO (Transmission System Operator) – and the private sector. The private sector is composed by small companies by taking under concession small hydro plants and small generation companies. These plants produce very low proportion of the total generation (41.3 million kWh in 2004). Their participation in the sector started 3-4 years ago, and 2004 was the first year that these companies started to make rehabilitation. The authorities aim is to assure that KESH purchases their energy production, in order to have guaranteed future investments. Besides, the sales prices are approved by ERE (Electricity Regulatory Authority) based on the generated electricity cost. The first eligible customers have been licensed, as one of the first steps towards liberalization and opening the market.

KESH holds the monopoly position in the domestic market. Its task is generation, import and distribution of the electricity. KESH owns 99% of the electricity in the Albanian market and it imports alone. Due to the weak collection of electricity bills, the widespread illegal use of electricity and the low retail electricity prices the KESH had serious financial problems, which is slowly being solved. In 2000 the government started to provide subsidy, in order to prevent the institute from being unable to pay for the imports. In addition, since 2001 certain actions were taken to improve collection and to reduce illegal electricity consumption. The tariff levels are being gradually increased. 2005 may be the first year that KESH can pay for the electricity imports without government subsidy, though the level of import continues to be high.

CHART 4. – ELECTRICITY BALANCE (IN GWH)



Source: Bank of Albania, Albanian Electro-Energetic Corporation

Electricity tariffs are still considered to be low. Household customers use 68-70% of electricity billed in local level and the approved average tariff for this category for 2005 is 5.95 Lek/kWh¹. According to the National Strategy of Energy (based on DECON study financed by the World Bank), the prices will increase, and the tariff should move towards 9.33 Lek/kWh.

The main problems are the following:

- Albania is still dependent on the hydro energetic situation, drought means danger.
- Recently electricity import is around 10% injected to the network (the electricity market size is 6,033 TWh/year).
- Although electricity losses are decreasing, the quantity is still very high – in 2004 it amounted to 36.6%. The losses make significant cost for KESH and the customers as well.
- The level of collections of electricity bills is also improving, but is still considered poor – in 2004 the collection without government subsidy was 88% (LEK 27.132 million including government payments). For example the level of collections in the area of Shkodra is only 19.2%.
- There have been investments in order to equip customers with meters – last year 260 000 meters were installed, but still 75 914 customers remain without meters. This fact means a big problem for KESH, due to the fact that according to a law the last deadline for billing without meters (minimum usage assumption) was 31st December 2004.
- Although load shedding is decreasing it is still a remarkable problem (it was 550 GWh last year).
- The heavy industry zones outside Tirana suffer from power outages and devastating voltage fluctuations. (Due to these facts one of the biggest customers recently built its own oil-fired power plant, in order to be independent of KESH. There is a chance that KESH loses some other big consumers as well.)

ERE is a member of the Athens Forums, where the aim is helping the integration of the regulator in the new structures, while the final goal is the integration to the EU. The members make an effort to establish a regional energy market, liberalize and open the market, develop the competition, etc.

PROJECTS AND REFORMS

Certain developments have already been made. KESH has computerised the bill collection system and increased the amount of collections by 15%. The number of employees has fallen by 38%, so recently 7 500 people work at KESH. The unsustainably low tariffs have been raised, while the government provided subsidies to the poorest consumers. It has been agreed with the international institutes that KESH would be privatised over the medium term.

Recently the sector provides opportunities to invest. According to plans, a new thermal energy plant will be built in Vlora with 325 MW installed capacity, with the help of the World Bank, EIB and EBRD. The plant is scheduled to be on-line in 2007 and is expected to decrease the sectors rainfall-dependency. Smaller hydropower electric stations may be built in various districts and existing big hydropower plants shall be rehabilitated. Other investments will aim to improve the distribution system. According to plans, the utility will remain state owned, but the distribution system will be separated into two or three private companies. Some other energy resources – like oil, LPG and solar – will have increasing role.

There are two ongoing projects: the Power Sector Rehabilitation and Restructuring Project (PSRRP) and the Power Sector Generation and Restructuring Project (PSGRP). Their implementation is conditional on continued fulfilment of the targets set by the Action Plan. Beside these IDA projects, in 2005 a new project

¹ Recently EUR/LEK is 123.15.

should be started; the Energy Community of South East Europe's (ECSEE) program in Albania (ALP2-Albania) would provide investment support and technical assistance for the country. The aim is to extend the lifetime and improve the quality, reliability, safety and efficiency of the bulk power transmission system through replacing time-worn equipment with new ones. High-voltage equipment in six transmission substations, and control and protection systems in six transmission substations would be replaced. The other part of the project would contain technical assistance, which would serve to facilitate project implementation, it would strengthen the TSO, and improve the tariff structure and the procurement procedures applicable to electricity imports. The ALP2-Albania project costs USD 52.14 million, and is mainly financed by loans from IDA and EBRD. The closing date of the project is supposed to be 2009.

Hopefully certain secondary legislations will be approved this year in the field of licensing, monitoring, export and import that serve the opening of the market, liberalization and the development of the competition. These regulations will help creating the integration of the regional electricity market in South East Europe and will serve the goals of the EU Internal Electricity Market.

If the reform process will continue the energy sector of Albania will go through major changes, including shifts from government to private ownerships and investments. Sustained efforts are essential, supported by severely needed investments. It is important to implement the legislative and regulatory framework in order to attract private investment. The Albanian electricity sector's problems are deep-rooted, so as a result the support of the international institutes will be needed in the ongoing period of time.