

EARLY WARNING REPORT ROMANIA

UNDP - ROMANIAN ACADEMIC SOCIETY (SAR)

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SOME BASIC INDICATORS

INDICATORS	Jan 2001	Feb 2001	Mar 2001	Apr 2001	May 2001	Jun 2001	Jul 2001	
Devaluation of the leu, %	2.5	2.2	1.8	2.1	2.2	1.5		↓
Inflation, %	3.7	2.3	2	2.7	1.7	1.6		↓
Industrial output, %	3.9	3.4	11.5	-3.7	7.8			↑
Unemployment rate, %	10.8	10.8	10.4	9.9	9.3	8.8		↓
Employed (,000)	4,416	4,450	4,470	4,488				↑
Trade deficit (mil. USD)	-261	-332		-448	-484			↑
Gross monthly salary (USD)	138	127	136	155	149			-
Foreign companies increasing their business in Romania (KPMG quarterly poll), %		55			70*			↑
Trust in government (BOP poll), %	50	52		51	44			↓
The current government can improve things (CURS poll), %			57			46		↓
Pessimism, % (Country heading in the wrong direction)	53	54			52		54	-
Subjective welfare, % (Better off than last year)	17	18		16.1	19			-

* forecast

Abstract

As the typical summer 'equatorial flat' downs upon Romania, no spectacular political events or economic developments are to be expected. The businesses remain cautiously optimistic, the economy displays moderate growth, pushed forward by the industrial sector, while inflation and devaluation seem to be under control for the first time after many years of drift. Several important privatizations were finalized or almost finalized (Banca Agricola, Sidex) but others look likely to fail (Oltchim, CS Resita). Unemployment is at historic lows – which suggests that this is the best moment to take bold steps in restructuring the state-owned industrial sector. However, the trade deficit keeps widening, because of, among other things, the generous import facilities awarded to SMEs earlier this year. This evolution, if continued,

would imply the need to accelerate the rate of devaluation of the leu, which may threaten the anti-inflation policy announced by the government and the central bank.

Overdue health care reforms were finally implemented, but not all of their outcomes are positive. Instead of an increase in spending on primary care and medical drugs (benefiting the poorest groups of the population), we witness a steady rise in costs of hospital (specialized) care.

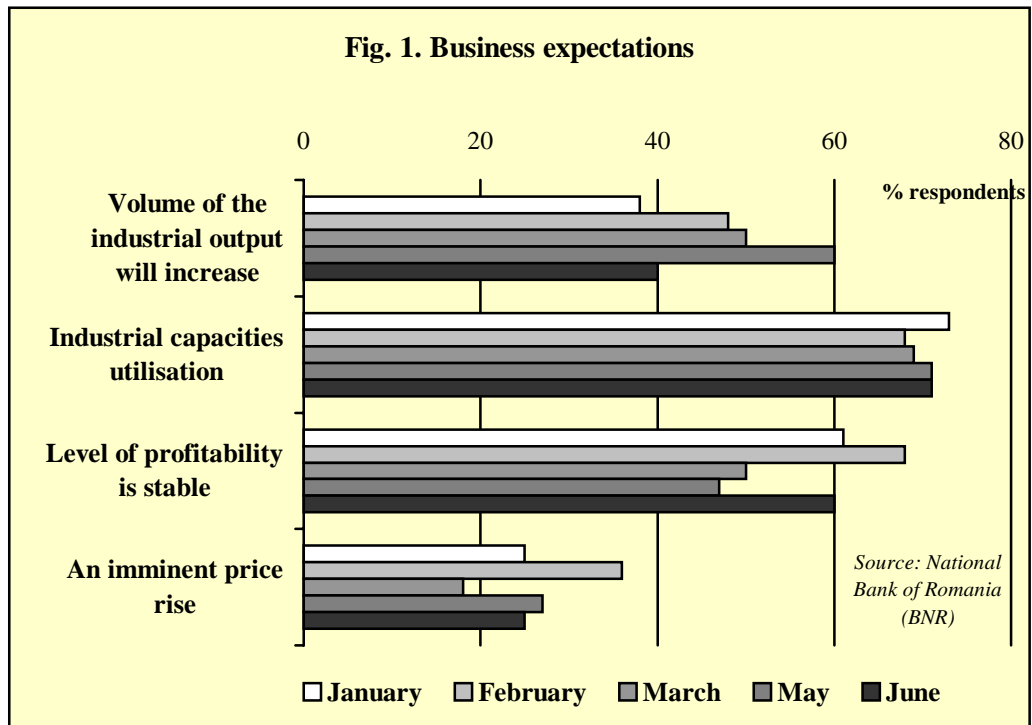
Romania was recently evaluated negatively by the US State Department on the issue of human trafficking. This negative evaluation should not be a reason for overreacting. There are simple steps which can be taken by the Romanian authorities in order to effectively curb trafficking in human beings, and, actually, most of the necessary actions are already under way. The most important warning in this issue of the EWR is the decreasing trust in the judiciary displayed by the Romanian citizens. Urgent action is needed to improve the performance and image of the judiciary (Social and Legal sections).

ECONOMY

BUSINESS IS GOOD, BUT THE TRADE DEFICIT WIDENS

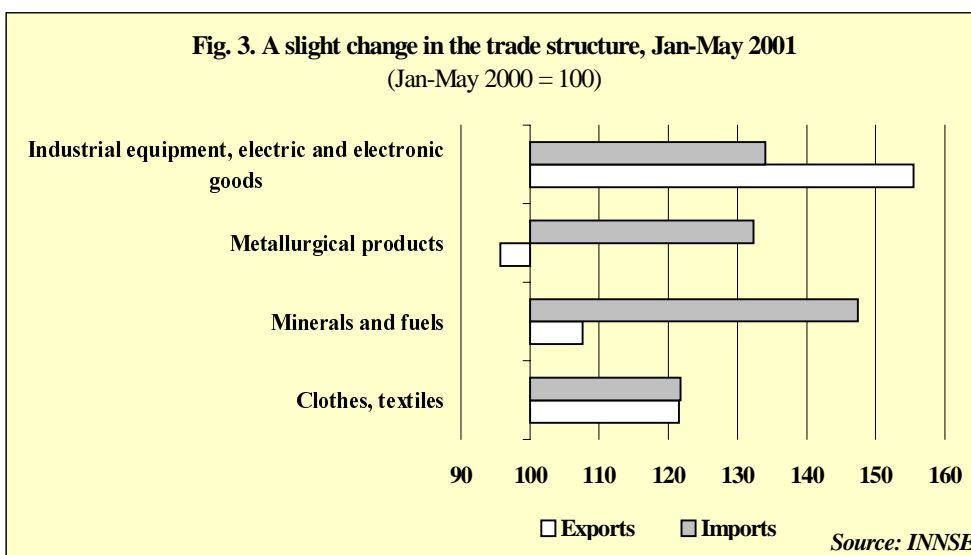
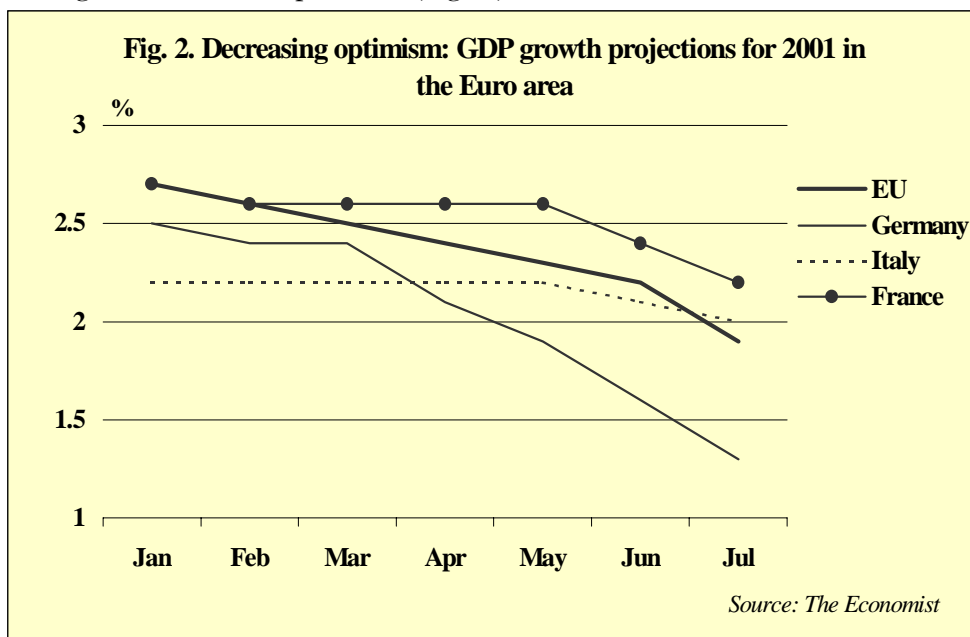
Expectations of the Business Community (first six months - 2001)

The National Bank of Romania (BNR) opinion poll shows continuity in most of the trends monitored since January. Entrepreneurs are still optimistic, but there is also some concern regarding the continuation of industrial growth – in June, the expectations in this respect fell back to January levels.



Trade and the international environment

In spite of the declining growth and confidence in the Euro area (Fig.2) Romania currently trades more with EU countries than last year. The surge in exports to EU by 26% in Jan-May 2001 compared with the same period of last year, coupled with a slight change in the composition of exports (less metallurgical products, more industrial and consumer equipment and machinery) suggests that the Romanian industry is moving towards quality and higher value-added products (Fig. 3.).



FOCUS: IS ROMANIA'S RATING REALLY ON THE RISE?

This issue's guest editorial is by Professor Daniel Daianu

A few months ago, Standard & Poor's, one of the main western rating agencies, raised Romania's rating from B- to B. This was a big relief for a country, which not long ago (in 1999), was threatened by external default. **What are the prospects now and could Romania come close to an investment grade in the foreseeable future which would propel her nearer to the main EU candidate countries?** In order to answer these questions, a bit of background history could be useful.

For those who closely observe transition economies, Romania provides a typical example of boom and bust. There was substantial growth during the period between 1993-1996, which explains the B/B- rating the country received from the main western rating agencies. But those years of growth were achieved at the expense of mounting tensions in the banking system and a rapidly increasing external debt. In spite of heavy borrowing on international capital markets, the official foreign exchange reserves of the country stood at less than US\$ 700 million at the end of 1996, whereas monthly inflation reached double digit levels. When the growth period came to an end, a severe adjustment was in the making in order to avoid grave difficulties. The adjustment undertaken in 1997 relied on further price liberalizations, unification of the exchange rate, massive cuts in subsidies, accelerating privatization, etc. The policy turnaround invigorated the stock exchange for a period and replenished Central Bank reserves. With the benefit of hindsight, that policy of adjustment, arguably, fended off the worst possible consequences of contagion, which engulfed world financial markets after the fall of the Thai baht in late 1997.

Yet the economic plunge was unavoidable, owing to the toughness of the austerity measures. The GDP declined by 6.6% in 1997, 5.4% in 1998, and 3.2% in 1999; by almost 16% cumulatively. There was also a bout of high inflation in 1997, due to corrective measures taken that year; as a consequence, inflation, which reached at 151% in 1997, dropped to 40.6% in 1998. Another shock came in 1999, when very high debt service payments were due, which brought in the specter of external default. The threat was further reinforced by the IMF's new philosophy of burden sharing with private investors, promoted in a period when private investors were withdrawing from emerging markets, following the Russian crisis. Being denied access to international private capital markets (due to exorbitant interest rates), Romania could avert default only by an exceptional balance of

payments adjustment. The latter involved substantial expenditure switching and cutting, which almost halved the current account deficit to 4% of GDP; the national currency depreciated considerably in real terms and the budget deficit was brought down to 2.2% (without including privatization revenues). What is less talked about is the social cost of this policy. At the end of 2000 not fewer than 45% of the population (as compared to 22% in 1996) lived below the poverty line, which suggests a high social cost and deep frustrations, as well as tremendous challenges for policy-makers in the years to come. These challenges consist in working out policies which foster economic growth simultaneously with protecting social cohesion.

Last year brought a slight economic recovery (+1.6%), fueled primarily by a significant increase of exports, of more than 20%. The recovery has also sped up this year, with a rise of the GDP projected at more than 4%. Inflation is on a descending trend; after 40.7% last year, inflation could come down to 30-31% this year. The cleaning up of the banking system made an important stride forward with the restructuring of Bancorex and its merger (actually its take over by) Banca Comerciala, and the sale of Banca Agricola to a foreign consortium. There is also a slight recovery in investment. And not least, the bulging reserves (including gold) of the Central Bank, which reached US\$ 4.5 billion (i.e. 4 months of imports) at the end of June this year, would justify S&P's decision to upgrade Romania's rating.

But there are pieces of bad news as well. Not quite unexpectedly – in view of the expansionary policies pursued by the current government and the Central Bank—the trade deficit (FOB/CIF) soared to US\$ 1.75 billion in the first five months of 2001. Unless corrective measures are urgently adopted, the trade deficit could easily surpass US\$ 4 billion this year, which would bring the current account deficit to more than 8% of GDP. Such a current account deficit would question the sustainability of the current policy thrust.

What lies behind the surge in imports? A set of explanations would have to highlight, inter alia: the unwarranted linkage of wages to expected inflation instead of productivity; a worsening of financial discipline among big state owned companies –mirrored by the rise of arrears by over 30%; fiscal and trade incentives, which raised the propensity to import, a recent real appreciation of the leu and, not least, an increasing budget deficit (programmed at 3.7% for this year).

Some may argue that the concern regarding the size of the balance of payments current account deficit is overblown since there is, seemingly, no pressure on the Leu on the foreign exchange market and, in addition, the real appreciation of the Leu does help disinflation. However attractive this line of reasoning may sound to some, there is ample ground to judge it as being shortsighted in view of several facts:

- The Romanian economy is still heavily dependent on compensatory flows, which are highly variable;
- Autonomous capital inflows are not insignificant, but they are mostly short-term and easily reversible;

- FDI inflows are much below the level recorded in the frontrunner transition countries and quite low in absolute terms and as a percentage of the current account deficit;
- The trend of productivity gains in the Romanian economy cannot be judged as permanent;
- World financial markets would become quite nervous about a current account deficit that is not financed from stable capital flows – the crises in Argentina and Turkey are quite ominous.

The issues linked with arrears and wage policies are likely to dominate the talks with the IMF mission next August. As a matter of fact, the delay in signing a new stand by agreement is a result of these very problems. Moreover, the soaring trade and current account deficit will be added as another hot topic to the talks. These issues will form the discussion core for the construction of the 2002 budget and of the policy mix, which, not surprisingly, will have to restrain the external deficits and improve financial discipline in the economy. One can surmise that the budget deficit target for next year would not exceed 3%, that the inflation target would be set at around 21-22%, and that the current account deficit would need to be targeted at substantially less than its current level. Cutting inflation to less than 25% in 2002 is very ambitious since inflation has become chronic; many enterprises “need” inflation in order to deal with arrears (reduce them in real terms) and inflationary expectations are powerful.

The need to reduce the current account deficit, and the corresponding policies to be pursued to this end, would very likely dent the growth, which was envisaged for next year; instead of 5%, the growth rate may have to be scaled down to 4%. The Government would have to work hard in imposing financial discipline in the state sector, in fostering privatization, in restraining wage demands from the unions, in simplifying the fiscal regime and making it more transparent, and in moving forward with the pension system reform.

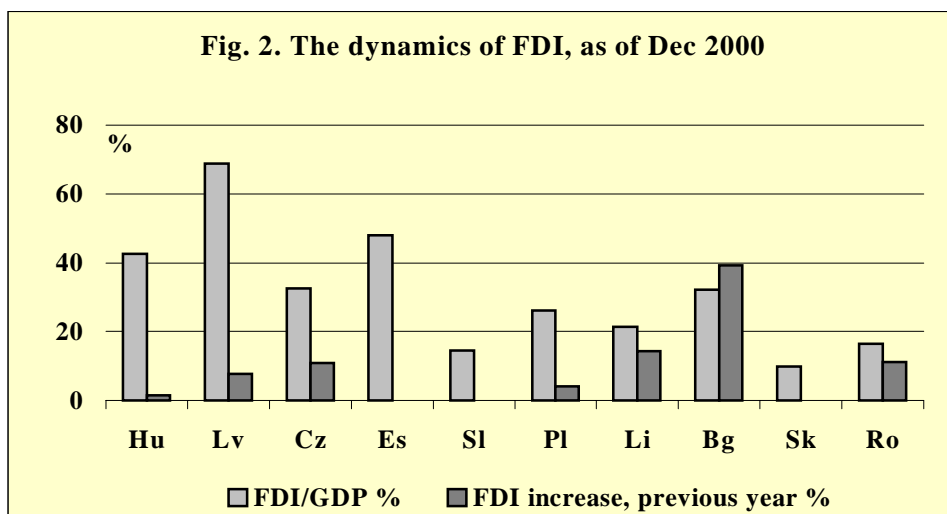
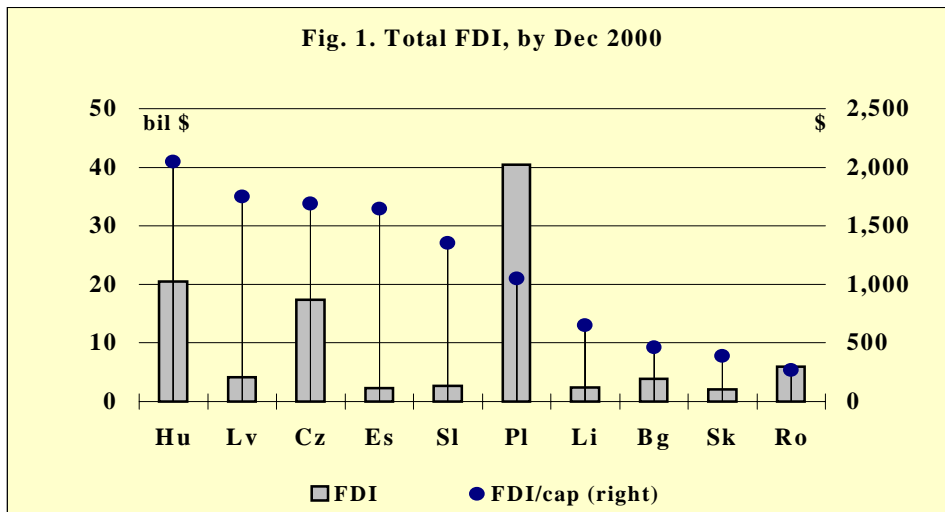
The final act in the sale of Banca Agricola and the privatization of Sidex would enhance the Government’s reform commitments and send positive signals to the business community, at home and abroad. At the same time, Sidex’s privatization would save the jobs of thousands of workers on a solid basis and would ease the burden on the public budget (the giant steel conglomerate costs the budget US\$ 250 million yearly).

There has been some progress in the last 18 months, which is illustrated by certain economic indicators; but the road ahead is still littered with menaces and the way to deal with them is to have a Government determined to go forward by not succumbing to the pressures of vested interests. Otherwise, Romania would continue to muddle through, in spite of having been invited to start accession talks with the EU.

FOCUS: FOREIGN DIRECT INVESTMENT

The lowest FDI *per capita* in the region, and the blame rests mostly with the Romanian governments

As in many other respects, Romania ranks last among CEE countries negotiating admission into the EU in respect to the amount of investments by international companies. The total FDI in Romania is very low for the second largest country, in terms of size, in the region, and the lowest FDI/capita (Fig. 1). Despite addressing the issue and the sense of urgency that has prevailed lately in Bucharest, things have not improved much and the gap separating us from Bulgaria, the main regional point of comparison, continues to widen. While Sofia can support, with real data, its claims that privatization has accelerated (Fig. 2), Romania has been stuck in a phase of good intentions and in drafting its institutional framework.



Every new Romanian government after 1990 pronounced, at some stage, a fresh beginning with foreign investors. In fact, there has never been a coherent strategy and a stable legislative framework concerning investments, whether foreign or domestic, because either the Romanian authorities did not want to give up control of the economy, or they repeatedly changed their minds about the right system of incentives. Overall, two main stages can be discerned.

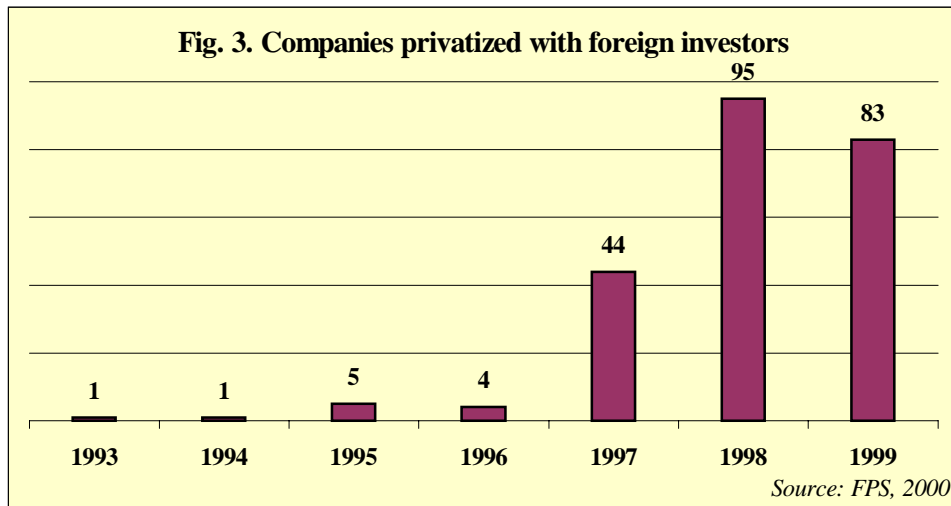
- **Before 1997**, the fear of foreign investors was high – and sometimes pathological. The ruling post-communist coalition was not convinced that privatization with multinationals was necessary, and focused its efforts on the inconsequential mass privatization scheme. This stagnation proved beneficial for domestic business groups with political connections. Very few companies were sold (Fig. 3), and no banks, since they were regarded as a tool for promoting the government's expansionary policies.

Unfortunately, the period between 1991-1996 was the most favorable for privatization in Central and Eastern Europe. The world economy was on the rise and the major investors' mood towards emerging markets was running high, and this was when most of our CEE neighbors privatized. The positive attitude was never recovered after the Asian slump and the Russian crisis, which explains in part why it has been so difficult to find good investors subsequently.

The opportunities lost during this period by the previous PDSR governments, especially by the one run by Nicolae Vacaroiu, are incalculable. According to most analysts, major Romanian companies are worth two or three times less today than ten years ago (Fig. 4) – and these are the good ones that eventually managed to find a buyer. Firms that were worse off are still state-owned and no investors have shown interest (ex. Promex Braila, a large industrial equipment plant, which has often been included in various privatization programs, but to no avail). Most probably, the politics of delaying privatization in early '90s stripped many of the state industrial and banking assets of whatever value they might have had after the fall of Communism, and left Romania with a FDI handicap that could not be overcome ever since.

- **After 1997**, the new center-right governments were less ideologically constrained to sell to foreign strategic investors. However, besides the swing of the international business climate, they were also incoherent. A flurry of contradictory Emergency Ordinances and Methodological Norms were issued in 1997 and early 1998, with the aim of putting foreign and domestic investors on a par – which meant in practice to extend to the latter the same facilities granted to the former. Finally, two years of effort and negotiations were summarized in the new Investment Law (241/1998) passed by the parliament in December. But only two weeks later the government changed its mind and eliminated most of the facilities, in return for lowering the corporate

profit tax. The new provisions were incorporated into the 1999 Budget Law, approved by the parliament in March. More than two years were thus lost, just to reach the simple ideas of a non-discriminatory and neutral investment regime, and an overall reduction of corporate tax.



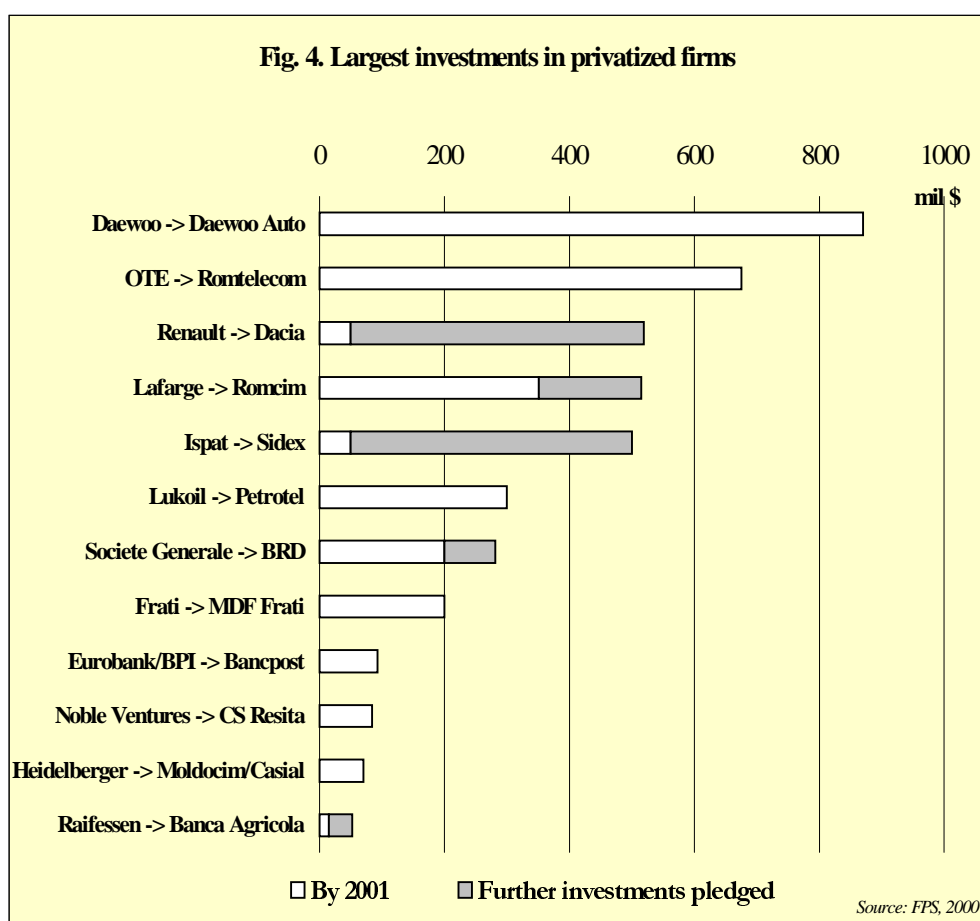
The new PSD (the former PDSR) government that took power in December 2000 has given signs of a break with their old practices, by luring in foreign investors. Banca Agricola was sold earlier this year, and Sidex Galati is in the final stage of privatization. However, there are still many things the government should / or should not do in order to boost its credibility with the international business sector.

- Privatization should be sped up in *tourism* and *agriculture*, since it has lagged for no good reason, and because productivity in these sectors is abysmal and there are no serious social problems associated with their restructuring.
- A clear schedule should be set for privatizing *BCR*, the largest Romanian bank. The selling of *BCR* has been regarded for some years by the international financial institutions and independent observers as a test case for the willingness of the Romanian authorities to give up political control over commercial lending. The fact that the bank has been kept in a state of uncertainty for more than three years, with no convincing explanation as to why all the deadlines were missed, suggests that either the government is reluctant to sell its last financial outlet, or underlying pressure from stakeholders (creditors and employees) has been too high. In either case, the government's credibility suffers. The strange silence surrounding *BCR* casts doubt over the statement of a top Central Bank official, that the bank will be ready for privatization by the end of 2001.
- The government should not be overgenerous with facilities and tax breaks, only to withdraw them later, when it becomes clear that they

are unaffordable. All business surveys show that legal and institutional instability, and not taxation, is the main problem for multinational corporations in Romania. The new Law on Foreign Investment introduced in June offers substantial advantages to large investors, both foreign and domestic. After what happened between 1997-1999 (and given the law's poor drafting, see below) its reliability will remain low – at least until the 2002 draft budget is endorsed, in early autumn.

- The government should not convey the impression that privatization contracts signed by APAPS (former FPS, the State Ownership Fund) with foreign investors can be 'reassessed' or even suspended by political decision. In the case of CS Resita, a steel plant sold to a smallish American firm with cash flow problems, the members of the cabinet were just too happy to issue threatening statements before they knew the exact legal limits of their intervention. Similarly, an embarrassing soap opera is currently going on in the form of an investigation into the 1998 privatization of Romtelecom, the national telephone monopoly. It still remains to be seen if there were any wrongdoings in this case. Many investment bankers suggest that a conclusion could have been reached without much fuss, by starting with the careful reading of the contract (including the confidential clauses) and comparing the success fee paid (about 1.3%) and the procedures (the commission was paid to consultants by the part who had hired them – in this case the seller, not the buyer). Meanwhile, the high-profile investigation of former ministers and foreign CEOs, who are brought for hearings to a shabby police station under a media spotlight, looks more like settling political scores than trying to settle a commercial litigation, if there is any.

More generally, the new government has a problem of language and appearance, which, if not fixed soon, threatens to become its trademark. The prime minister and other top officials, probably because they lack good and timely technical advice, rush to judgment and issue inflammatory utterances, only to backtrack later. Last month when the new law on foreign investments was being discussed, the PM scorned at the IMF and the World Bank's reservations regarding the facilities and tax breaks reintroduced: 'if they don't get it, we'll explain it to them again – twice, three times, until they understand'. These days the media is full of articles that point out to the vague provisions, amateurish phrasing and contradictions in the law. A less obnoxious approach to international officials and investors, especially given the long history of mediocre performance, would allow the current government to appear more professional before its business partners.



ROMANIA'S ENVIRONMENTAL FUND: THE GREEN ROAD TO EUROPE

Since the beginning of the transition towards a market economy, environmental funds have been a mainstay of CEE countries' efforts to address the communist legacy of environmental damage and the misallocation of natural resources. Nearly all countries in the region have at least one environmental fund and a few countries (Poland, Lithuania, Latvia, Bulgaria) have two or more, organized at the national, regional, or local levels. The funds share a common goal – assisting in the co-financing of environmental activities – but differ in their size, organizational structure, procedures for selecting projects, sources of revenue, and methods of distribution.

Some funds support broad-based environmental and natural resource projects while others are narrowly focused funds that finance the operations of a single park or protected area. Some funds are organized through government structures while others are independent legal entities such as trusts or foundations.

The Role of Environmental Funds

Environmental funds play two important roles in environmental and natural resource policy. First, environmental funds are a tool of environmental policy, providing financial resources for environmental and natural resource purposes. Second, environmental funds are institutions that can make a strategic contribution to environmental and natural resources policy.

Environmental funds, through their financial support, may address funding shortfalls in governmental conservation programs and provide a source of funding for organizations such as conservation and environmental NGOs with limited fundraising capabilities to cover operations and project costs. These two funding needs reflect the focus of “parks” and “grants” funds that have been established with the support of USAID and the UNEP/UNDP/World Bank Global Environmental Facility (GEF) to promote conservation and biodiversity objectives.

In countries with weak or developing capital markets, environmental funds may also provide financing for environmental investments and business developments at attractive (subsidized) financing terms for organizations with poor access to capital. This type of support reduces polluters’ costs and creates incentives for facilities to address environmental problems ahead of compliance deadlines or compensate for the weak environmental enforcement capacity that is pervasive in developing countries.

Also, the environmental funds often provide considerable scope for public participation in governance and their procedures are structured to promote transparency and accountability. Thus, funds may demonstrate these important principles and serve as a catalyst for government agencies to accommodate public participation and access to information.

The experience of CEE countries

In CEE countries there are 21 operational Environmental Funds (some countries operate 2 or 3 such schemes).

Only Albania, Romania and Croatia do not have Environmental Funds.

This instrument is not a part of the environmental acquis, but is strongly recommended by the EU as an important instrument for solving the complex environmental problems that exist in transition countries.

The amount of revenues administered by the funds gives an illustration of some of the differences. In 1997, aggregate revenues of the eight CEE “national” environmental funds surveyed (which excludes the Polish and Bulgarian EcoFunds, which nevertheless operate nation-wide, and the

Krakow Provincial Fund), totaled approximately US\$ 720 mil., or US\$ 9.44/capita. In contrast, the corresponding figures for the eight NIS "national" environmental funds surveyed (which excludes Russia's National Pollution Abatement Facility), are approximately US\$ 36 mil., or US\$ 0.16/capita. Even within the CEE and NIS regions the funds differ dramatically, at least in size. The 1997 revenues of Russia's Federal Environmental Fund (US\$ 18 mil.), for instance, exceed the combined revenues of all other national funds in the NIS for that same year (US\$ 17 mil.). The same can be said of Poland's National Fund for Environmental Protection and Water Management, whose 1997 revenues of about US\$ 403 mil. surpassed the aggregate revenues of the other CEE national environmental funds that year (US\$ 317 mil.).

The evolution, effectiveness and potential of the funds is closely linked with the broader progress being made by CEEC/NIS with economic and political reforms, as well as with developments in national environmental policy frameworks. **While funds may help to overcome some of the environmental financing challenges encountered during the transition period, they are not substitutes for fundamental reforms and should not be expected to fully mitigate the shortcomings of such reforms.** Significant differences in the development and potential of the funds can be seen between the CEEC, where reforms have been fairly steady and are advanced, and the NIS, where reforms have been less consistent.

Even as many CEE/NIS countries begin to benefit from successful reforms and to make progress through the "transition" period, environmental funds, endorsed as potentially effective transitional instruments, continue to play significant roles in financing environmental protection in the regions.

The Situation in Romania

In Romania, the Environmental Fund Law was promulgated in May 2000 as a Parliamentary initiative (Law no. 73/2000). This law was intended on one hand to solve one of the most important environmental issues in Romania and, on the other hand, to respond to EU concerns about the lack of economic instruments in dealing with pollution. ("The cost of compliance with the environmental acquis has only been roughly estimated but, according to a study financed by the European Commission, its order of magnitude is of approximately US\$ 20 billion. A rational use of all the financial resources available is essential as well as the promotion of financial instruments related to the efficient use of natural resources and the respect of the "polluter pays" principle. **In this context, the establishment of an operational Environmental Fund should be considered a top priority.**" - 2000 Regular Report from the Commission on Romania's progress towards accession)

Generally, the very fact that the legal basis for the Romanian Fund was established by Parliamentary Law was an important achievement, compared with many other CEE countries. However, the law was drafted in a "quick and careless" way that made its application impossible.

This was very disappointing given the fact that discussions regarding the establishment of an environmental fund in Romania had been taken place for several years. There is a wide body of experience concerning the advantages and flaws of other funds in the region. International experience provided a perspective on certain fundamental problems in relation with: revenues, functioning mechanisms, and disbursement mechanisms. The most important shortcomings of the law were:

- Lack of clear, specific mandate and objectives for the Fund and lack of a termination clause;
- Lack of clear legal status;
- Unclear definition of responsibilities of different bodies within the Fund;
- Unclear accountability and transparency provisions;
- Lack of provisions for cost-effectiveness;
- Legally weak, distorted and unpredictable revenue sources;
- Risky disbursement instruments and high fiscal risk due to contingent liabilities.

For instance in regards to accountability and transparency provisions the law does not provide for external financial audits to be conducted by independently chartered accountants and by the fiscal (treasury) authorities. Neither does it provide for legal audits (checking for the compliance with the laws) to be undertaken by the State Auditing Authority, or for performance audits (evaluation against stated objectives and performance standards) to be conducted by a relevant entity.

The law does not include performance criteria to be later evaluated by the Steering Committee and the Board of Directors. This problem may be corrected in the regulations for the Fund that are to be developed by the Government.

The law does not clearly define to whom the Fund should report to and who should elaborate and approve the reporting standards. There exists a very ambiguous statement in Art 6(e) that a report on the funds destinations and usage should be made public. Placing the reporting responsibility with the lowest structure (Executive Secretariat) runs against good international standards.

In what revenue sources are concerned, there are several important issues to be highlighted.

In order to achieve its objectives, meet its commitments, and prepare realistic programs and budgets, the Fund needs a predictable and stable revenue stream. Hence, the revenue composition is of utmost importance. Unfortunately the revenue sources listed in Art 9 are very controversial. The law does not identify institutions responsible for the collecting of revenues and the proportions to be allocated to the Fund. Art 9(2) provides for it to be

determined by Government decree. Normally no government agency will have the incentive to collect revenues, which will have to be later transferred to another institution (i.e. the Environmental Fund), unless there is a legal requirement to do so. It will be difficult for government agencies to agree on who will take on this additional burden and even more difficult to enforce collection later on. Revenue sharing arrangements usually strengthen the incentives for effective revenue collection. The law does not mention sanctions for delayed payments, other than a very weak provision in Art 12(2).

The revenue sources represent a bizarre mixture of administrative charges, sales taxes (second and sixth tier), pollution charges and others. In most cases the revenue sources for the Fund involve tax competition and only Art 9(1)(b) includes a disclaimer. Equally, Art 9(1)(a) involves competition with the revenue for environmental administration, which will cause either resistance to collect these charges by environmental authorities, or claims on the funds expenditure (for the financing of the administration from the regular budget).

If the Fund will provide loans, as hinted in Art. 10(2)(c), and loan guarantees, the law should explicitly state that repayments of loan principal and interest as well as credit guarantee fees can provide revenue sources for the Fund. Otherwise they are illegal. By the same token, interest on bank deposits should be legally allowed as a form of revenue if Art 8 is to be effective.

The law does not provide for an income tax exemption on Fund revenues, it neither refers to the required changes in the Tax Law, nor does it give the Ministry of Finance the delegation to apply tax exemptions.

Fig. 1. Environmental Funds in CEE Countries

Country and Fund	1996 Reven. (mil \$)	Major Sources of Revenue (% of revenue)		Major Disbursement Mechanisms (% of funds)	
		Leading Source	Second Source	Primary	Secondary
Bulgaria: National Environmental Protection Fund	8.9	Carryover 31%	Import Duty on Used Cars 21%	Grants 46%	No interest loans 45%
Bulgaria National Trust Fund	5.5	Debt Swap 74%	Profits/ financial operations 23%		
Czech Republic: State Environmental Fund	197	Env Fees 49%	Privatization proceeds 37%	Grants 55%	Soft loans 43%
Estonia: National Environmental Protection Fund	6.7	Env Fees 50%	Water use charge 21%	Grants 95%	Soft loans 1%
Hungary: Central Environmental Protection Fund	93	Fuel charges 47%	Product charges 29%	Grants 51%	No interest loans 17%
Poland: National Fund for Environmental Protection and Water Management	433	Env Fees 49%	Loan repayments 30%	Soft loans 64% in 1995	Grants 18% in 1995
Poland: EcoFund	31.3	Debt Swap 89%	Profits/ financial operations 10%	Grants 100%	
Poland: Krakow Regional Environmental Protection Fund	17.2	Env Fees 61%	Profits/ financial operations 28%	Soft loans 73%	Grants 24%
Slovak Republic: State Environmental Fund	42.7	Env Fees 67%	State budget 22%	Grants 100%	
Slovenia: Environmental Development Fund	24.5	Carryover 38%	Privatization proceeds 23%	Soft loans 100%	

Source: "Sourcebook on Environmental Funds in Economies in Transition: a Regional Overview and Surveys of Selected Environmental Funds in Central and Eastern Europe and the New Independent States." October 1999, OECD

Most fiscal (or quasi fiscal) instruments to raise revenue for the Fund seem very distortionary and leave a great room for discretion with the authorities in charge of collection. For instance what legal definition is used to determine the products with a short life cycle? It is not known if all these instruments are already in use and definitions, rates, billing and collection systems are already in place. If not (as implied by Art 9.2), than establishing of a good systems within 3 months seems very ambitious.

Another series of problems lie with chancy disbursement instruments and high fiscal risk due to contingent liabilities.

Article 10(1) provides a list of eligible projects, which is all-inclusive and will provide little guidance to the Fund as to what its priorities are and how to

implement them. We have already discussed hazards of such abroad and the ambiguous definition of Funds objectives and eligibility criteria.

Article 10(2) of the law provides for the following disbursement mechanisms:

- Interest subsidies on credits provided by banks;
- Guarantees for Government borrowing for public (infrastructure) projects;
- Guarantees on bank credits provided to firms and direct loans to enterprises for introducing cleaner technologies;
- Awards for special achievements by enterprises/organisations.

Out of all these instruments, only interest subsidies and "awards" are not controversial. Interest subsidies are relatively simple to manage, have a high leverage effect and can help the Fund accumulate experience with financial management, contracting, project appraisal, etc.

All other financial products listed in Art 10 require advanced and sophisticated risk management skills. It is essential for the disbursement instruments to be adjusted to the institutional and managerial capacity of the funds. In other CEE and NIS funds it was usually best to first allow the fund to use simpler instruments, such as direct grants and interest subsidies in order to accumulate experience with financial management, contracting, project appraisal and implementation monitoring. Major financial failures occurred when newly created, understaffed funds issued resource intensive financial products such as direct loans, equity or loan guarantees. Unless a loan department was created (with at least 2-3 experienced credit analysts) to analyse creditworthiness and the borrowers collateral, or the task was contracted out to commercial banks (for a fee), the loan portfolios would usually quickly turn into a stock of worthless assets.

Allowing the Fund to issue contingent liabilities such as a credit guarantee is particularly dangerous. Most environmental funds in CEE are not allowed to do so. The limited experience with loan guarantees has so far been unfortunate. For example, over-commitment of loan guarantees and forward commitments of grants (in lieu of expected revenue) has caused serious liquidity risk to the Czech Republic's Environmental Fund and triggered management replacement (the Fund collapsed later on).

As a result of the above-mentioned problems, the law could not be applied since its promulgation. In the meantime, due to domestic and external pressures, the Government issued an Emergency Ordinance to address some of the law's shortcomings.

Emergency Ordinance No. 93/21.06.2001 brings some changes to the Law but does not solve all the problems. Accountability and transparency provisions are not included in the new Ordinance, and the decision mechanism within the Fund has not been clarified.

However, a spectacular change, not seen across CEE countries, was made in respect to revenues. Now the biggest contribution to the Fund will consist in

a 20% share of scrap iron exports and a 30% share of timber (and logs) and nonferrous waste exports.

Collecting revenues will, however, be a challenging enterprise, taking into account that no country in Europe has done this for Environmental Funds. All the more so, since there is no mechanism for collection, despite the fact that on paper the potential for those revenues is of around US\$ 125 mil./year. Another problem lies with the narrowness and instability of the tax base. It seems that, in choosing these revenues, the intention is to reduce exports of the above-mentioned raw materials instead of collecting revenues for the Environmental Fund.

Equally, there is no new provision that deals with VAT exceptions for fund activities.

There is an improvement regarding disbursement mechanisms; more options were added such as: grants, the co-financing of projects financed by foreign sources, interest subsidising, and carry-over. Unfortunately, the provision regarding guarantees has only been modified by limiting the guarantee to 60% of the loan.

Law 73 should be amended with the provisions in the Emergency Ordinance by Parliament. This will be a good chance to further improve the law, in order to make it functional.

SOCIAL

CASE STUDY: THE METALLURGICAL SECTOR AND THE PRIVATIZATION OF SIDEX

The Resita steel plant conflict created unrest throughout the whole metallurgical industry. Due to the forthcoming privatization of Sidex, the steel industry seems in danger to become a tension ridden sector with a high potential for conflict. The Metarom union, which represents the workers in this industry is a cohesive, quite autonomous federation, despite its formal affiliation to Cartel Alfa, which seems to increase the risk of conflict even further.

Income in the steel industry

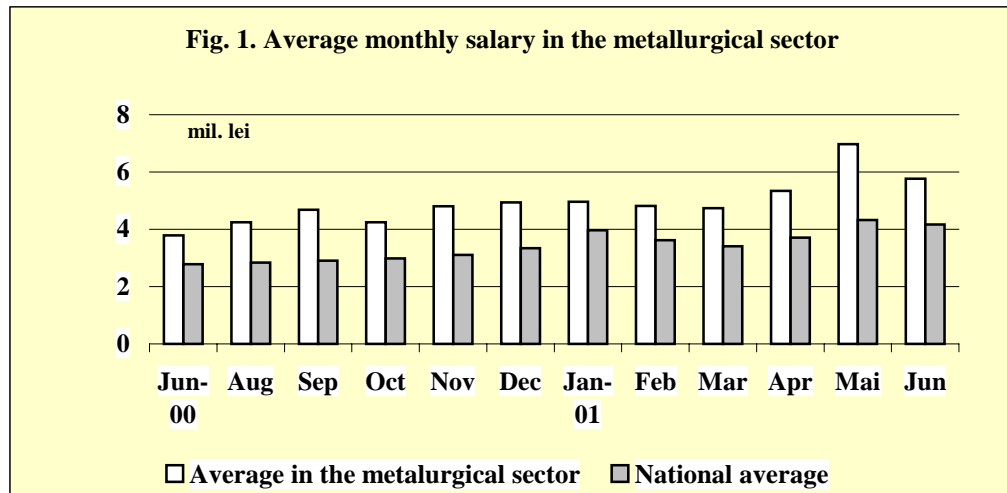
The Romanian steel industry includes 21 units. Among the most important are Sidex Galati, now to be privatized to ISPAT, COS Resita, COS Hunedoara, COS Călan, Otelul Rosu, COS Târgoviste, Laminorul Focsani, Petrotub Roman, Siderca Calarasi, Industria Sirmei Cimpia Turzii, Carsiun Hirsova. Four of these - Sidex, Resita, Otelul Rosu, Siderca - are going through various phases of privatization - a process which seems plagued by controversy.

This is an industry where the gross salary level is 30% above the national average. It is true that, in the broad picture, steel industry wages (5,768,000 lei) registered a slight decrease, but this is only because one of the main units in the industry - Resita - did not pay workers' wages at all.

Labor claims

Although wages in the sector are relatively high, Metarom is one of the most active trade union organizations. Initially, trade union claims only targeted wage policy. Gradually, with the escalation of the conflict in Resita and the

passing of Pension Law 19/2000, their claims started focusing also on this latter legislation.



The first type of claims was focusing on wages, namely:

1. re-negotiating the industry collective agreement – ferrous and non-ferrous metal processing
2. increasing the minimum wage negotiated in 2000 by 75,000 lei, correlated with inflation and Law 19/2000 (Pension Law). This would lead to an increase of the minimum wage in the branch to US\$ 90/month (2,700,000 lei)

During the July negotiations, employers suggested that wages only be indexed with 80% of the inflation rate and in response to the impact of Law 19/2000. Subsequent to negotiations between Metarom and the Ministry of Labor, the minimum salary in the industry has been established at 2,400,000 lei, starting with July 1 (2,500,000 starting with October 1).

The second type of claims targets important legislative changes. They were first put on the agenda by two units affiliated with Metarom – Târgoviste and Galati – but were subsequently adopted by the higher echelons of the trade unions (the Metarom federation and even the Alfa confederation). These claims focus on the consequences of the new pension law. They are, according to the President of COS Târgoviste, Nicolae Coman:

1. Modifying Ordinance 79/2001 on the methodology for correlating wages and inflation rate
2. Modifying the pension law so as steel industry employees included in Group 1 can retire when reaching the age of fifty, as they did under the old pension law.

In Târgoviste, there are no tensions because there have been no lay-offs lately (on the contrary, workers were hired during the past month), so that the

union leaders blame problems in the sector mostly on the trade policies, which allegedly need revising.

Will Sidex become another Resita?

Union representatives of Sidex Galati are mainly unhappy with the application methodology for Pension Law 19/2000. These concerns are not specific to the situation at Sidex, but are the same in the whole industry:

- maintaining lower retirement ages for employees in categories 1 and 2
- changing the pension calculation system and their level according to OUG 79/2001

Pensions calculated under the new system are allegedly only half of those defined by the old legislation¹. Consequently, if before April 1 an average worker at Sidex could retire on a 3,5 million lei pension, after that date his or her pension becomes only 1,8 mil. These claims have already made the subject of a trade union rally on July 16, showing how serious the concern of the union members is. Since the transfer of property is not yet completed, these issues could still compromise the whole process.

The events in Resita could create a dangerous precedent if the already tense situation at Sidex becomes even tenser with the approaching privatization. The change of owners, even if it does not, according to negotiations, lead to lay-offs, will bring about managerial and structural modifications triggering tensions and uncertainty. Against this background, the current claims may receive an even greater support and become reasons for conflict, specially with the external influences that promote trade union claims in order to compromise the privatization (i.e. collaborators, current partner companies etc., who benefit from the current state-owned status of Sidex).

The claims raised lately by trade unions should therefore be solved before the ownership transfer is performed. The current claims are aimed at legislative changes related to labor policy, so only indirectly connected to the future owner, and therefore should be solved beforehand. Otherwise a bizarre situation could result, same as in the Resita case, where the union from a private enterprise negotiates not with the employer but with the state.

The Sidex union's main grievance is against the pension system. The union leaders suggested that an exception could be made to the law allowing for Sidex employees to retire under the old provisions for the next five years.

How should labor negotiations be approached?

By taking into account the strategic mistakes made in the Resita case (see the last issue of our report) but also the specific elements of the privatization in

¹ Interview by the expert with Marcel Oancea, Sidex trade union leader.

the case of Sidex, the following recommendations could be made in order to relieve tension prior to the ownership transfer:

1. Closing the current labor disputes before the ownership transfer is completed.
2. The two major claims (early retirement age and a redefining of the pension calculation system) can be solved by establishing an early retirement mechanism, via a compensation system based on funds created by the new owner (to be included in the privatization contract). This is the only level at which APAPS can discuss labor-related issues.
3. The non-involvement of APAPS in post-privatization labor negotiations is desirable. The Social and Economic Council representatives are the only ones who can mediate between owners and employees. The privatization agency (APAPS) should stay within the boundary of its attributions specified by law and privatization contracts.
4. Containing the claims regarding the pension law to Sidex (especially if solutions are available) or to Metarom at most. As currently there are tensions between the leaderships of big confederations and the steel industry unions, especially those from Sidex, negotiations should take place at the lower level, with no confederation involvement.
5. APAPS should establish, immediately after the privatization takes effect, a transparent mechanism of control with clearly defined deadlines and public reports.

THE REFORM OF THE HEALTH CARE SYSTEM: KNOCKING AT THE WRONG DOOR

Defying the logic of reform, the hospital sector takes now a larger share of health care resources than before. The policy changes under consideration by the Ministry of Health will either be irrelevant or downright detrimental.

Romanian health care reform aimed to increase the overall resources allocated to health care and to shift the emphasis from in-patient to primary care. Three years after the nation-wide introduction of the new funding system – social insurance – the “pie” for the health system has substantially increased. However, hospitals consume an even larger share of this pie, due to the lack of effective cost-containment incentives in a non-competitive system dominated by hospital doctors. The situation has the risk of affecting the funds available for the primary care – an essential element of the reform

strategy -, and for subsidized drugs – a paramount social issue. The new administration has correctly identified the hospital sector as the weak link of the reform. Its key policy proposals, however, either fail to correct the problem – the new funding system based on the case mix (DRG) – or might make the situation even worse – the partial privatization of hospital clinics, that runs the risk of shifting private costs to the already over-burdened public sector.

Background

Romanian health care reform has been under consideration for most of the 1990s. The crucial piece of legislation, the Law of Social Health Insurance, was passed in 1997, and became effective in 1998. The law replaced the old funding system, based on national taxation, with a payroll-hypothecated tax (social insurance), administered by regional (county) health funds.

The two most important objectives of the reform process were:

- To increase the overall resources for health, and
- To shift the emphasis from in-patient care, to primary care

For example, Fig. 1. summarizes the major problems to be resolved, in the view of consultants who helped draft the reforms. Low funding and emphasis on specialist care figured prominently.

Fig. 1. Pre-reform strategy. Bottlenecks and problems in Romanian health care

*Insufficient funding

⇒ specially low incentives for professionals

*Poor health indicators

*Inefficiencies:

⇒ Emphasis on specialist care

⇒ High hospitalization rates

⇒ Surplus of hospital beds and high occupancy rates (but no staff surplus)

* Insufficient quality assurance

* Poor performance of certain prevention programs

* Existence of parallel health care systems

* Decreased access in rural areas

* Unclear ownership of facilities

Source: BASYS, 1997

The reform process moved further in primary care, which was effectively privatized through the introduction of family doctors and the change of the funding system to one based mainly upon capitation. There was much less progress in the hospital sector. The ownership of facilities is still unclear, and

funding is still based on traditional budgetary distribution. **Health funds, which theoretically belong to the purchasers of health services, and have to enter into contracts with the providers, failed to act selectively and had little impact upon the behavior of providers.**

Healthcare Funding

Romania used to spend 2-3% of the GDP for health care. This was one of the lowest shares of GDP devoted to health among CEE countries (even if, according to the World Bank, it was consistent with the development level of the country). The health status of the Romanian population also looked worse than in neighboring countries. In this context, policy makers considered the level of spending insufficient; therefore social insurance was introduced to mitigate the situation.

Fig. 2. shows that since its introduction in 1998, social insurance has reached this goal. Public expenditure on health care increased to 4% of the GDP. When private expenditure is added, the total amounts to almost 5%. While this is still low by European Union standards, and even by the statistics of other CEE countries, it is a considerable increase in relative terms from the early 1990's.

Fig. 2. Evolution of health expenditure – relative terms

Funding sources	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total public health expenditure out of the GDP (%)	2.7	2.8	3.1	3.0	3.1	3.1	3	2.8	3.2	4.0	4.0
Total health expenditure out of the GDP (%)	3.5	3.5					3.7	3.5	4.1	4.9	-

The increase is substantial, as also shown in Fig. 3, which presents the evolution of health expenditures calculated in US dollars.

Fig. 3. Evolution of health expenditure – absolute terms

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total public health expenditure (bil. USD)	1.09	0.81	0.6	0.78	0.93	1.09	1.05	0.98	1.3	1.37	1.34

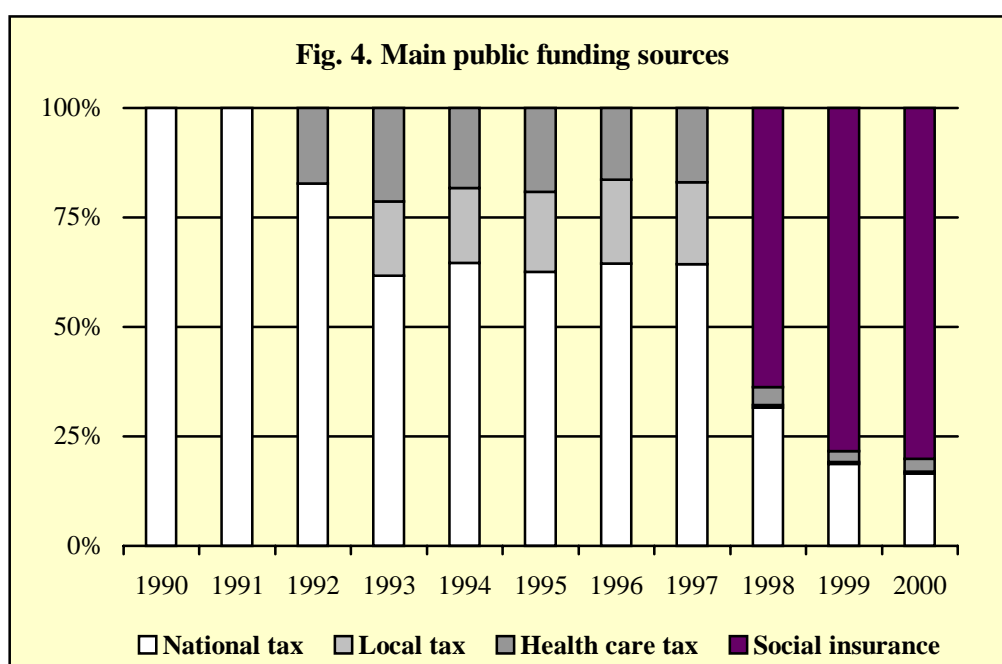
Social insurance has now become the main source of funding for the health care sector. Fig. 4 presents the evolution of the sources of funding. Currently, social insurance accounts for over 80% of health care finance.

Hospital sector

Romania entered the reforms with an over-bloated hospital sector – not unlike most CEE and even EU countries however. The main indicators used to assess efficiency in the hospital sector are:

- Number of beds,
- Occupancy rate
- Number of admissions, and
- Length of stay

The latest statistics available present Romania's figures at the higher end, but within the expected range, in reference to all the indicators. The rate of admissions (about 20/100 people), and the length of stay (about 10 days) are in the higher numbers in WHO Europe region as a whole, and average for CEE countries. The occupancy rate (about 75%) is in the lower half, while the number of beds (over 7/1000 people) is in the higher one.



In assessing this performance we have to take into account that all the countries we benchmark with have a dire situation in the hospital sector: they all attempt to reduce the number of beds, admissions and length of stay, and to increase the occupancy rate. A situation which is slightly worse than their average is, therefore, still problematic.

However, it is important that over the 1990's these indicators moved in the right direction. The number of beds declined sharply by about 20%, while the admission rate remained nearly the same. This boosted the occupancy rate. The length of stay declined by about 15%.

The most important conclusion from the point of view of funding is that the utilization indicators have not worsened. This shows that the pressure for increased spending does not come from a larger number of cases.

Hospital funding

Fig. 5 lists once again the reformers' expectations concerning the allocation of resources within the health care sector. We can clearly see the intended shift of resources away from the hospital sector, and into primary care.

Fig. 5. Wishful thinking: 1997 pre-reform strategy.

Kind of health care	Current (1997) financial allocation of resources, %	Estimated financial allocation of resources, %
1. Hospitals	50	35
2. Secondary care	30	30
3. Primary health care	20	35

Source: BASYS, 1997

Fig. 6 presents the resource allocation breakdown within the health care sector. Presented are the provisions of the framework contract (drafted at the beginning of the year), and of the "summer budget" – the mid-year correction of the budget.

Each year, the share allocated by the summer budget for hospitals was over-shot by actual expenditures. The reverse is true for primary care and drug expenditures. This data suggests the inability of the budgetary sector to respect budget constraints. We have to bear in mind that, as fig. 7 proves, the resources actually collected have always been smaller than the estimated. This resulted in lower than expected expenditures. As a consequence, a higher than expected share for hospital expenditures means lower than expected real resources for primary care and prescription drugs. **From the champion of reforms, primary care has become the Cinderella of budget allocations.**

The fact is that Romania spends, in relative terms, more on hospitals, and less on primary care and prescription drugs than most OECD countries. **In addition, we have to bear in mind that this breakdown is based on the expenditures of health care funds. The share of hospital expenditures would be even higher if the 20% of public expenditures were to be taken into consideration.**

Fig. 6. Health care expenditures: a comparison between actual expenses and the amount provided by the National Framework Contract (NFC), and the revised mid-term budget (MTB)

Type of service, %	1998 Actual	1999 NFC	1999 MTB	1999 Actual	2000 NFC	2000 MTB	2000 Actual
Primary care	9	15.5	9.5	9	14.5-15	9.8	9.5
Out-patient (specialists)	5.8	11.7	6.6	6.1	8.7	7.8	7.2
Hospitals	67.2	40	61.2	64.1	59-61	64	65.5
Subsidised drugs	6.8	20	9.3	8	10-11	12.8	12.4
Dentistry	2.7	4.2	2.8	2.4	2.5-3	1.6	1.4
Rehabilitation services	0.8	1	1.2	1.1	1	0.6	0.6
Prosthesis	3.2	3	0.6	0.3	1	0.3	0.3
Ambulance services	4.3	4.5	3.8	3.7	3-4	3	3
Health programmes	0.1	0	5	5.2	0.1-1	0	0
Total	100	100	100	100	100	100	100

Fig. 7. Income and expenses of Health Care Funds 1998-2000

Bil. ROL ,000	1998			1999			2000		
	Budget law	(*)	Actual	Budget law	(*)	Actual	Budget law	(*)	
Income	10.3	9.5	8.4	11.9	20.4	18.4	26.7	29	
Total expenses	7.6	7.6	7.4	11.4	17	15.9	23.9	25.2	
Reserve funds	-	-	-	0.6	0.96	0.8	1.3	1.4	
Balance	2.7	1.9	0.9	0	2.5	1.6	2.3	2.3	

(*) Mid-term budget adjustment

To put things into context, Fig. 8 presents the break down of resources by sector in health care for OECD countries.

Fig. 8. Public health care expenditure broken down by sector in OECD countries

Public expenditures by health care sector out of total public health care expenditures, %	Average	Max	Min
Hospitals	54	78	30
Prescription Drugs	13	27	6
Out-patient services	21	40	8

This is even more surprising when taking into account that in the early 1990's Romania and the Czech Republic were the champions for prescription drug spending. The expectations for a country like Romania is to spend a greater percentage on prescription drugs compared with western countries, because the prices of tradable goods such as prescription drugs vary less among countries than the price of labour. Therefore, one would expect the labour intensive sectors to take a lower share from the overall resources in Romania, as compared with Western Europe.

An institutional explanation

The root of the problem is the lack of adequate institutional incentives for cost-containment at the hospital level. The hospital sector is very powerful politically, as it is comprised of the medical elites. The problem is made worse by the fact that the members of this elite are the decision-makers at all levels of the health care system.

The lack of competition between health care funds (that are regional monopolies, and therefore do not have to compete for clients) creates an institutional framework where there is no incentive for the health care fund to confront these powerful interest groups and enforce hard budget constraints upon hospitals. The dominant strategy is an alliance of the purchaser with the provider to pass the costs on to the budget.

In addition, the autonomy of hospital managers is limited, which precludes even the restructuring measures intended by public-spirited managers.

Reform plans of the government

The previous administration had come to terms with the profligacy of the hospital sector, and accommodated their increased expenditure. The new leadership in the Ministry of Health and Family has identified hospital sector reform as its priority. However, it is less clear whether the new decision-makers understand the mechanisms that led to the current situation, and - if they do - how are the policies that have been announced going to mitigate the situation.

The main initiatives consist of changing the funding system to DRG (diagnosis groups), and partial privatization. Theoretically, basing the funding on the case-mix rather than on actual costs would encourage hospitals to be more efficient. The problem is that DRG *per se* could lead to more efficient interventions, but not necessarily result in overall cost reductions. More important, the full implementation of DRG is a very complicated process, which is going to take years, as proven by the Hungarian experience (the first CEE country to use this method). Therefore, whatever benefits it will bring, DRG is not going to be a solution for the short term.

Privatization is a tricky matter. Whether this means the outsourcing of some services, or even the privatization of hotel services, it will improve efficiency. Partial privatization of hotel facilities, however, bears the risk that a part of the private facilities costs will be passed to the public section of the hospital.

A much better alternative would be the outright privatization of hospital sector (or creating new private hospitals).

While both policies have things to be commended for, they fail to address the cost containment of hospital expenditures and the looming crises in the primary care and pharmaceuticals.

Conclusions

In spite of improved overall funding for health care and no increase in utilization rates, hospitals consume an even greater share of health care resources. Romania, despite its low wages, is in the paradoxical situation of allocating larger shares of public health care resources to hospitals than other OECD countries. This situation presents obvious social and political risks. In addition, it undermines the role of primary care as the champion of reform.

The initiatives of the new administration concerning the hospital sector fail to address the cost-containment problem. While the shift to case-mix funding and the privatization are commendable, their effects will not be seen for years to come. Moreover, partial privatization of hospital clinics might worsen the financial problem in the public sector, resources from the latter being detoured by managers to private patients.

POLITICS

TREND ANALYSIS: POLITICAL TRUST AND PREFERENCE²

As the effects of the latest elections are fading away, the decline in political trust can play a critical role once the Government moves for the unpopular measures it is bound to take.

The government's decline in public trust reported in our previous issue is confirmed. The polling institute CURS reports that a majority of the population is now skeptical towards the overall direction of the country, despite the Government scoring well on both the Schengen 'black' visa issue and the Report of the European Parliament. The decline of public trust in the government shows that we are entering a second phase of government support after the relaxation which usually follows the elections: the government is progressively reduced to the trust of its basic constituency, and further decline of support in the urban areas is to be expected. However, as the situation of the political opposition seems to degrade rather than improve, the main challenges to this government come from the economic and social situation and not from the opposition and media. By and large, the government also seems to continue enjoying a friendly media, with the exception of Culture Minister Razvan Teodorescu, author of a few highly controversial decisions.

² Data from the CURS poll of July 2001 sponsored by the Romanian Association for Freedom and Development (ARLD) and the June Metromedia Barometer of Opinion sponsored by the Open Society Foundation. References are made to a previous March CURS poll.

Fig. 1. Public mood on life and government (%)

	February	March	May	June
Romania heading nowhere or in the wrong direction	54	39	52	46
Satisfied with living conditions	18		25	
Optimism with one's economic future in one year's time	36		19	
Trust in President	58		48	
Trust in Prime Minister	67		49	
Trust in main opposition leader (Traian Basescu)	65		50	
Trust in government	52		44	
Trust in Judiciary	40		29	

The parties preference situation has remained quite stable.

Fig. 2. Voters' options

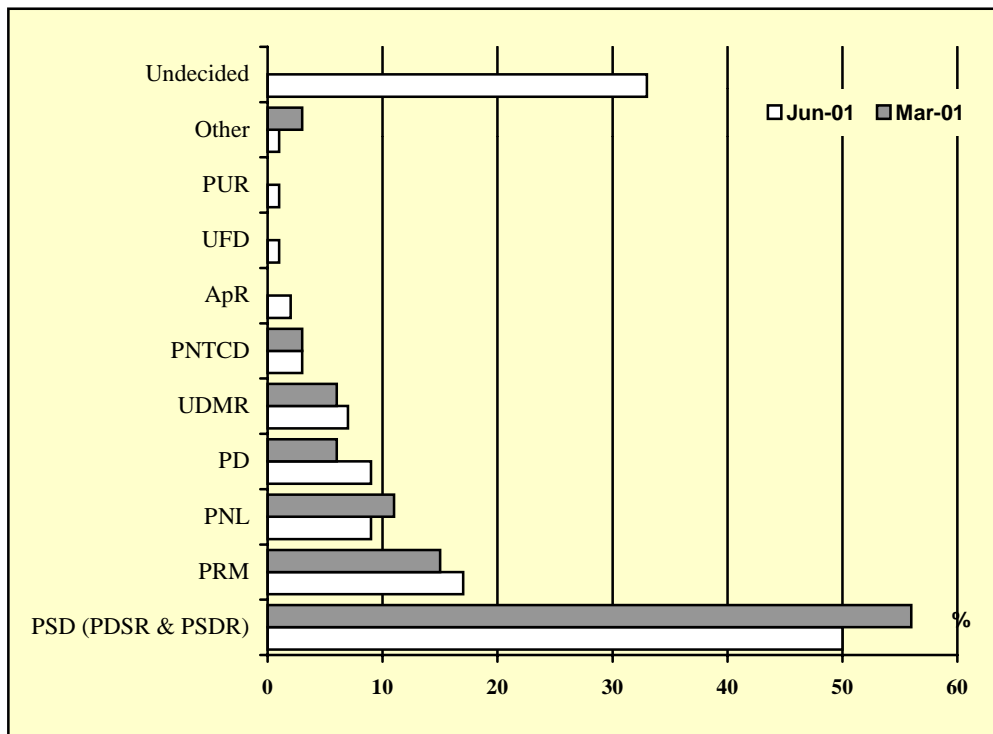


Fig. 3. Crosstab: former and current vote preference (%)

Today's vote preference	Latest elections vote				
	PDSR	PRM	PNL	ApR	PD
PDSR	89.1	4.1	1.5	-	3.1
PRM	8.2	82	3.1	-	3.6
PNL	11.3	3.2	75.8	-	4.8
ApR	12.5	12.5	25	25	25
PD	7.4	1.9	5.6	1.9	81.5

Based on BOP data, *Metromedia*, June 2001.

A closer look at the public confidence top, still led by Adrian Nastase, Ion Iliescu and Traian Basescu, shows a cleavage between rural areas, endorsing Ion Iliescu, and urban ones endorsing both Nastase and Basescu. Confidence in the leader of the government party and the main leader of the opposition is significantly correlated (Pearson 0.282). All other things being equal, Basescu is endorsed by a younger generation compared to Nastase. Determinants of trust in Ion Iliescu are different, however, as President Iliescu remains still the main public figure trusted by the worse off, the old and the peasants, in other words by those strongly dissatisfied with their lives.

Fig. 4. Explanatory OLS regression models. Trust in political leaders

Determinants	Trust Iliescu	Trust Basescu	Trust Nastase
Wealth ³	- ***	NS	NS
Age	**	NS	*
Education	NS	NS	NS
Town size ⁴	***	- *	NS
Satisfied with one's life	- *	NS	NS
Trust Government	***	**	***
Trust trade unions	NS	***	NS
Trust political parties	NS	*	*
Trust Parliament	NS	NS	NS
Trust state companies	NS	NS	NS
Adjusted R ²	0.156	0.072	0.140

* significant at $p < 0.05$, ** significant at $p < 0.01$, *** significant at $p < 0.000$; - indicates a negative correlation. NS signifies the variable did not turn out as a predictor.

³ Scales ascending if not otherwise specified.

⁴ 1 to 6, 6 is village

Fig. 5. Subjective assessment of one's living standards evolution (%)

	Living standard compared to last year	Expectations for living standard in one year's time
Much worse	7	5
Worse	35	21
Same as last year	40	30
Better	15	29
Much Better	1	
No Answer	2	14

The top of worst fears of the population has remained basically the same as over the last years, with fear of price rises and sickness on the first two positions. The fear of a war and its effects in the region ranks only fourth with about a fifth of the total answers.

Fig. 6. Which are your two main concerns?

People's most stringent worries (% , only relevant choices out of a larger number of indices)	Most stringent	Second most stringent
Prices	52	49
Disease	43	46
Future of children	38	39
War in the region	19	18
Crime	17	20
Unemployment	16	17
Social Unrest	8	6

LEGAL

WARNING: HUMAN TRAFFICKING

The US State Department published a global report regarding human trafficking. The report divided states into three categories, according to the measures and the governments' interest in fighting this phenomenon.

The standards used in ranking different countries were clearly stated in the introduction of the report. As far as the minimal measures to combat human trafficking are concerned, the authors took into account the following aspects:

1. The government should prohibit trafficking and punish acts of trafficking.
2. The government should prescribe punishments commensurate with those for serious crimes (such as forcible sexual assault).
3. For knowing of any act of trafficking, the government should prescribe punishment that is sufficiently stringent to deter, and that adequately reflects the offense's heinous nature.
4. The government should make serious and sustained efforts to eliminate trafficking (such efforts are also defined by very precise criteria).

In evaluating governments' interest and their efforts in combating trafficking, the following criteria were considered:

- The extent of trafficking in the country;
- The extent of governmental non-compliance with the minimal standards, particularly the extent to which government officials have been compliant to trafficking;

- What are the appropriate measures that could compel a government to comply with the minimum standards considering resources and capabilities?

The report placed Romania in the third category, i.e. among those states that do not fully comply with the minimum standards and do not make significant efforts in this respect. It was also stated that certain countries from this third group have started to adopt measures meant to combat human trafficking; however, these states could not be ranked in a superior category just yet. The names of these states were not given, but – as it results from the chapter in which our country is presented – Romania is amongst them.

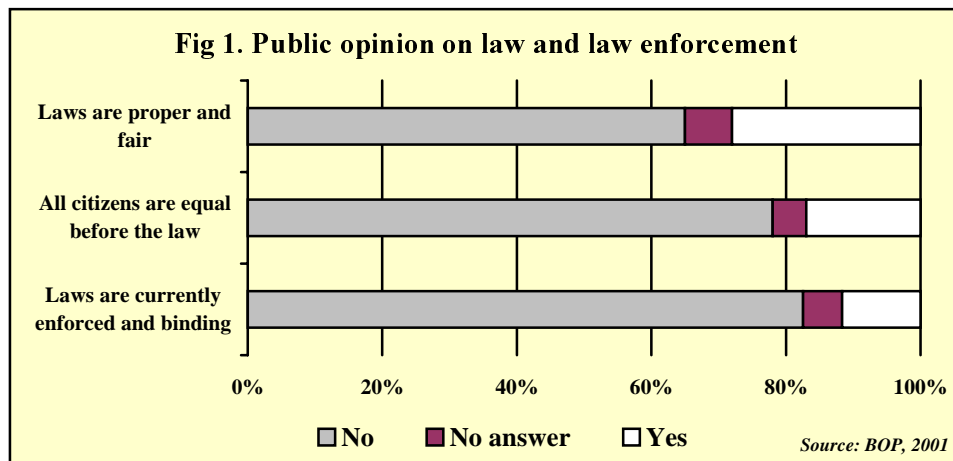
Romania is considered to be a country of origin and of transit for trafficking women to Turkey, Italy, Greece, and the Balkans for sexual exploitation. To a lesser extent, men are trafficked to Greece for agricultural labor. According to the report, the Romanian Government does not meet the minimum standards but has recently begun high-level efforts to combat trafficking.

The local press commented negatively Romania's ranking in this category and stressed only this aspect when presenting the report, thus failing to mention that the US Department of State had acknowledged the positive measures taken by the Government, such as appointing a national coordinator in charge with fighting human trafficking. More developed countries, such as Greece and Israel, were also placed in the same category with Romania. Romania's ranking in this group was the result of failing to comply with some logical and transparent criteria, such as the absence of an anti-trafficking law, if we are to give only one example. This being the case, the hasty reaction of the Prime Minister, who strongly criticized the report, is difficult to understand, since such reactions may give the false impression that the Romanian government is not interested in this issue and is not willing to take serious measures in this sense. Furthermore, this happened precisely at a moment where the first successes of the Romanian police in controlling this phenomenon could be reported: during the first six months of this year, 21 persons involved in human trafficking have been arrested and another 22 are currently on trial. Moreover, the FBI Resident in Bucharest declared to the press that Romania had made important progresses that have not been included in the Department of State report, which is based on information gathered until the month of April, and that in the future Romania may be ranked in a superior category.

Making efforts to fight human trafficking (the Government has recently formed an inter-ministerial committee to elaborate a law in this respect), while at the same time sending contrary political signals is highly unproductive.

WARNING: RULE OF LAW

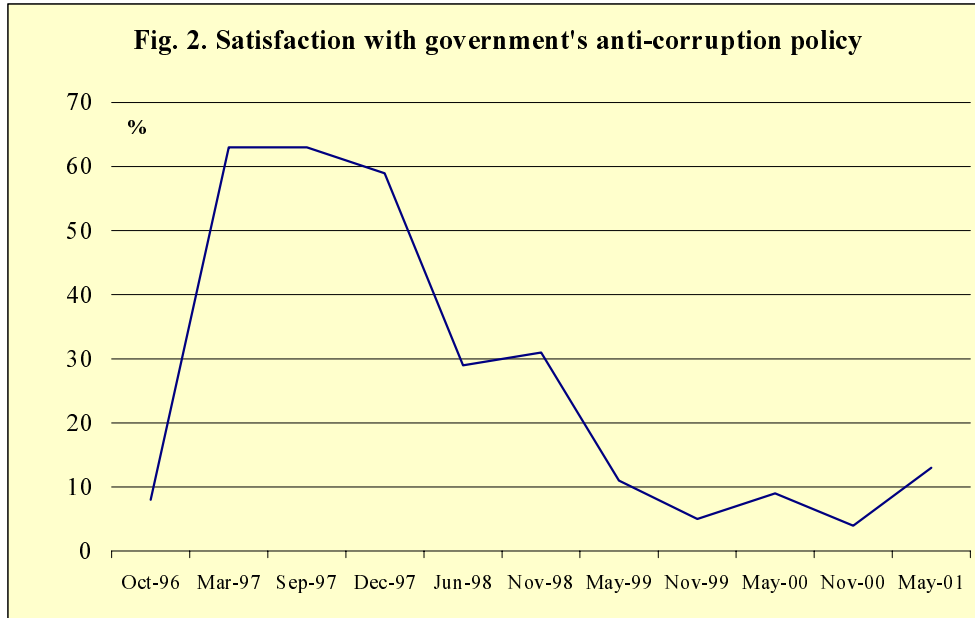
A majority of the Romanians distrust the judiciary, consider the laws as unjust and their application as unfair. 83% of Romanians consider that we cannot speak of the rule of law in Romania, as the laws are neither enforced by state agencies, nor abided by citizens.



The profile of distrustful citizens shows them as more likely to be worse off economically, not trusting in other agencies, such as the police, less educated and residing in smaller rather than larger towns. Since the perception that there is no rule of law is so widespread, however, this only shows that when comparing large cities and better off citizens with poor ones residing in small towns and villages, we find more diversified opinions amongst the former, and generalized feelings of mistrust and frustration with the current state of things amongst the latter.

Although only 14,7% of citizens had dealings with a Court during last year and only 19,8 had encounters with police activity, the almost general perception is that these institutions are ineffective and corrupt. A substantial amount of those who dealt with either the judiciary and the police report offering bribes to solve their claims. It is, therefore, urgent for the government to design and implement policies in order to create partnerships between communities and law enforcement agencies, and to make the judicial process more transparent. Even if the public perception is based on just rumors, indirect experience, second-hand reports from relatives, friends or neighbors, the government should be highly concerned. Having a majority of citizens who consider most laws as unfair and non-binding, the judiciary as

corrupted and the police as ineffective only reinforces the vicious circle of lawlessness. The vigorous campaign of the Internal Affairs Ministry on corruption of high-ranking policemen is a good start, but the judiciary will have to follow. Equally, since it is petty corruption, of traffic agents or civil servants working in Courts, that is more visible for citizens, this aspect has to be addressed as well.



Trend analysis of BOP data shows that symbolic gestures matter in the public fight with corruption, but are not enough. Due to strong rhetoric and a few arrests by the newly installed 1996 government, satisfaction with government activity against corruption jumped from 8% in October 1996 to 63% in March 1997. However, because of the ineffectiveness of the judiciary to prosecute to the end the cases publicized, by June 1998 only 29% of citizens still believed that former President Constantinescu's campaign on corruption was leading somewhere. By the 2000 elections the decline had reached the bottom. Expectations of 2000 compared to 1996 show a much more skeptical population: only 9% have joined since the elections the small group of citizens who are satisfied with the government's fight against corruption. The rhetoric doesn't work anymore: it is time for a policy that would also target low level, day-to-day corruption, and make no political discrimination among those prosecuted.

The Romanian Academic Society (SAR) is a think tank running research and advocacy programs in the areas of democratic governance and public sector reform, with the aim of promoting in Romania the ideas of sound government and Euro-Atlantic integration.

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