# UNDP Project Early Warning System
# ROM/99/006

Formulated by the

## Romanian Academic Society (SAR)

### DISCLAIMER

# Early Warning Report

# ROMANIA
# Issue #1 / 2003

**United Nations Development Programme – Romania Country Office**

**Romanian Academic Society (SAR)**

Bucharest, January 2003

# EARLY WARNING REPORT ROMANIA

## UNDP - ROMANIAN ACADEMIC SOCIETY (SAR)

# CONTENTS

## S E L E C T E D   I N D I C A T O R S

| | Q4 2001 | Jan 2002 | Feb 2002 | Mar 2002 | Apr 2002 | May 2002 | Jun 2002 | Jul 2002 | Aug 2002 | Sep 2002 | Oct 2002 | Nov 2002 | Dec 2002 | Year 2002 | Trend |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **GDP growth (quarterly, annualized), %** | 5.4 | | | **3.1** | | | **5.7** | | | **4.5** | | | | | ↗ |
| **Devaluation of the Leu, monthly average, %** | 1.2 | **1.9** | **1.3** | **0.9** | **1.7** | **0.2** | **-0.16** | **-1.7** | **0.7** | **-0.1** | **1.4** | **0.2** | **-0.3** | **6.02** | ↘ |
| **Inflation, monthly average, %** | 2.4 | **2.3** | **1.2** | **0.4** | **2** | **1.9** | **1.2** | **0.6** | **0.8** | **0.6** | **1.6** | **2.8** | **1.6** | **17.8** | ↘ |
| **Interest rate (BUBOR, one week) %** | 35 | **35.1** | **37.6** | **37.5** | **34.6** | **32.0** | **31.3** | **28.9** | **28.1** | **26.7** | **24.3** | **23.0** | **21.2** | | ↘ |
| **Industrial output, % change** | -3.0 | **4.6** | **3.8** | **5.6** | **1.7** | **2.0** | **1.1** | **2.5** | **-4.9** | **3.2** | **5.6** | | | | ↗ |
| **Trade deficit, monthly average FOB/CIF (million USD)** | 504 | **257** | **239** | **263** | **340** | **344** | **347** | **430** | **170** | **348** | **448.5** | **386.4** | | | ↘ |
| **Unemployment rate, %** | 8.1 | **12.4** | **13.2** | **13** | **11.1** | **10.2** | **9.6** | **9** | **8.5** | **8.2** | **8.0** | **8.0** | **8.1** | | ↘ |
| **Average net monthly salary, USD** | 96.4 | **114.1** | **106.3** | **111** | **118.5** | **114** | **121** | **122** | **117** | **116** | **118.0** | **120.1** | | | ↗ |
| **State pensioners / employees** | 1 | | | **1.01** | | | **1.011** | | | **1.013** | | | | | ↗ |
| **Trust in government, % (The current Government can improve things)** | 42 | **45** | | **38** | | | | **32** | | | | | | | ↘ |
| **Pessimism, % (Country heading in the wrong direction)** | 48 | **51** | | **57** | | | | **62** | | | | | | | ↗ |
| **Subjective welfare, % (Better off than last year)** | 22 | **11** | | **12** | | | | **11** | | | | | | | – |

** projection;* *** urban population only*

## ABSTRACT

In terms of macroeconomic performance, 2002 was Romania's best year since 1989, highlights the ***Economy*** section. However, in order to sustain such performance in the period ahead, the Government should pay more attention particularly to improving financial discipline and increasing the country's absorptive capacity of EU pre-accession funds. It is also argued that the current timetable for capital account liberalization should be revised. Equally in this section, an analysis of the impact of foreign direct investments on the Romanian economy, which shows that Romania, although with a lag, follows in the footsteps of more advanced EU accession countries from Central Europe.

The ***Politics*** section warns that political disputes within the Bucharest city-hall have very serious consequences for both the citizens and the credibility of the whole decentralization process. The present situation has a peculiar history of conflict along party lines, and it makes the Romanian capital virtually ungovernable. There is a way out from the current stand-off, however, and it is in the central government's power and interest to do something about it.

The lifting of Schengen visas seems to have helped Romania a lot – in financial terms, more than the total direct assistance in 2002. The ***Social*** section takes a look at the emerging migration patterns, one year into the visa-free régime for Romanian citizens, and concludes that this measure is actually benefiting all parties. The same section warns about the autonomy of universities being under threat because of a new law drafted by the Ministry of Education. While the government is rightfully concerned with the over-expansion of higher education compared to available resources and with the decline of its quality standards, the Ministry needs to thoroughly rethink some of its recent or envisaged measures or else it risks to antagonize the academic world. The article argues for a different approach.

# ECONOMY

## SIGNPOSTS TO WATCH IN 2003

### In terms of macroeconomic performance, 2002 was the best year since 1989

*by Daniel Dăianu*

WARNING

From the macroeconomic point of view 2002 was Romania's best year since 1989. As it was expected the annual inflation rate came close to 18% (against a 22% target), though one can harbor calculational qualms in relation to the dramatic change in the relative price of energy. But all in all, the macroeconomic picture validates Romania's upgrading by leading rating agencies.

**Fig. 1. Key macroeconomic figures**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| GDP, % real change | 1.6 | 5.3 | 4.5* |
| Inflation rate, Dec/Dec, % | 40.7 | 30.3 | 17.8 |
| Current account deficit, %GDP | -3.9 | -5.9 | -5.3** |
| Budgetary deficit, % GDP | -3.6 | -3.5 | -3.0** |
| Foreign official reserves, bn. USD | 4.9 | 6.5 | 7.3 |

**3 quarters  **IMF projection*

Can the evolution mentioned above be sustained in 2003, given the structural weaknesses lingering on in the Romanian economy? This question gets additional salience after the Prague and Copenhagen summits of last year, which raised the economic stakes in Romania's quest to join NATO and, particularly, the EU. The analysis below focuses on some key spots related to this question and should be seen in conjunction with the budget analysis in the last report (EWR 7/2002).

## I. STRUCTURAL POLICY

*Is financial discipline improving?*

It is an open secret that financial indiscipline still plagues the Romanian economy; for years now arrears (inter-enterprise debt; arrears to banks and the budget) have become a feature of the way companies try to make ends meet financially; some of them do it by using a perverse system of incentives in order to increase their profits, others do it with the aim of mere survival. As several previous EWRs highlighted, inflation has become a means for the system to achieve a certain state of "balance" by keeping arrears relatively constant in real terms (for, there are payments like wages, which cannot be made unless actual liquidity is available). At a time of substantial disinflation, and unless financial discipline improves accordingly, the economic machinery could suffocate after a while – when the amount of real arrears goes beyond threshold limits.

**Securing efficiency-enhancing investments for public utilities should be top priority**

2002 has been a year of substantial disinflation. Moreover, the big rise in the price of energy could not but strain the financial balance sheet of numerous energy suppliers to the extent that households and industrial users were not able to pay their bills. On the other hand, on the positive side, one can mention the decline of interest rates (during 2002), which reduces firms' refinancing costs, the *Ordinance* that tied the reduction (or rescheduling) of past debts with orderly current payments, and, possibly, more prudent wage policy in a series of state companies and regies. It may be that the latter positive tendencies put a lid on the expected rise in real arrears following the pace of disinflation. But only hard data can provide a clear answer in this respect. *Unfortunately, critical data on the volume and structure of arrears in 2002 are not yet available publicly. Arguably, this is the most important missing link in the overall picture,* in order to make a judgment on the pace of structural changes in the Romanian economy over the last couple of years.

The evolution of arrears would indicate, fairly clearly, immediate and longer term consequences for the public budget, the course of disinflation, and sustainable growth. Should arrears decline in real terms, this would mean less burdensome quasi-fiscal deficits for the public budget, more downward pressure on interest rates, higher efficacy in bringing inflation to a one digit level and higher propensity of firms to commit themselves to longer term investment. And vice versa, a surge of arrears would be ominously negative. Arrears should be a top priority on the radar screen of Government policy makers in 2003.

Arrears can be battled against by more determination in fending off vested interests, by political will in clamping down on those firms (state, or private), which ask for undue favors. Privatization can surely help, but it should not be seen as a miraculous device per se in hardening budget constraints. Experience shows that, frequently, private companies, too, engage in "the game" of producing arrears. Moreover, there are companies for which it is hard to find would be investors. To complicate matters even more, the situation of public utilities cannot be dealt with in a simplistic manner, by simply assuming that the way to raise the ratio of collected energy bills is to privatize utilities, whatever it takes. In their case one has to be concerned, first and foremost, with securing investments which enhance efficiency in production and distribution, and reduce, thereby, prices to end users. This should be another top priority for the Government.

### THE CAPACITY TO ABSORB EU FUNDS

The decision in Copenhagen to set a target for Romania's accession – assuming that critical economic criteria are met – is likely to put huge pressure on policy-makers. They have to do the utmost of what is possible while "time cannot be compressed at will" in certain respects. Romania faces enormous challenges in undertaking institutional reforms and in trying to cope with a formidable developmental handicap. This is why making good use of the pre-accession funds is a must for policy-makers; these funds could go to around 2.5% of GDP yearly by 2006, were Romania to prove an effective capacity to absorb them; but they can also stagnate, or even go down, should Romania bungle its way.

It goes without saying that Brussels will pay much attention to procedural aspects (like transparency, fairness, etc). In the end, however, what matters mostly is that the funds have the highest possible impact – via direct and indirect effects – on the Romanian economy and society. Thence arises the importance of the selection of good projects and their effective implementation.

## II. MACROECONOMIC POLICY

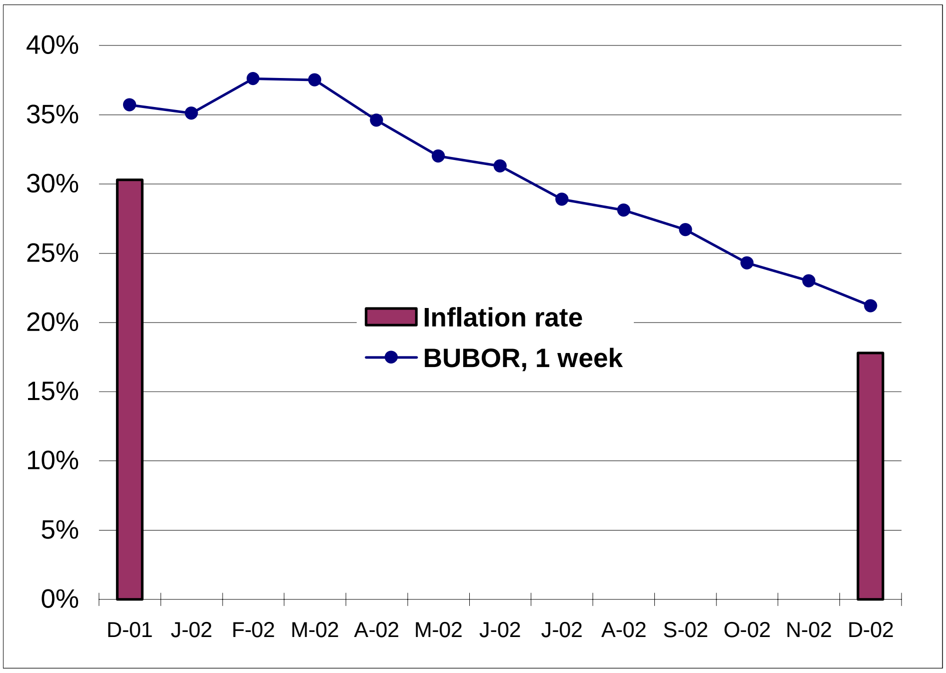
*Disinflation and monetary policy*

**The spread between active and passive interest rates makes borrowing in Lei costly**

Disinflation has been accompanied by a steep decline of nominal interest rates, especially in the second half of the year (Fig. 2). The reduction of inflation was facilitated by a major breakthrough in fighting inflationary expectations, which in turn was much helped by the nominal quasi-stability of the ROL (Romanian leu) during 2002, following the sharp appreciation of the euro vis-à-vis the USD. The cut in interest rates is also illustrated by the dynamic of yields for government paper (bills), which match rates for banks' time deposits.

The decline in nominal interest rates was overdue, against the backdrop of considerable disinflation. But, arguably, *there is not much scope for further decline of passive interest rates unless disinflation continues;* an overemphasis, now, on the reduction of these rates could harm individuals' propensity to hold their savings into ROL denominated deposits. It is true that the Central Bank's policy of ROL real appreciation creates an additional cushion in this regard, but it would be quite risky to assume that ordinary citizens combine interest rate differentials with exchange rate dynamics in their computations, on a systematic basis.

**Fig. 2. Inflation and interest rate, 2002**




*The key issue with respect to interest rates is the spread between active and passive rates;* this spread continues to be quite high (Fig. 3) and makes borrowing in ROL costly. Bank lending expanded substantially in 2002 (Fig. 4), but most of it was hard currency denominated, which was due to cost incentives and the ROL's real appreciation policy. Commercial banks complain that the high (and poorly remunerated) reserve requirements imposed by the NBR compel them to raise the spreads; and they have a valid point here. But the Central Bank does it not as a simple operational exercise; it has been forced to use all available means in order to sterilize the liquidity surplus in the economy in the quest to bring inflation down. Another argument, namely that risk premiums cannot be much lower in Romania yet, is also valid. But there is clearly much inefficiency in the banking sector, which is rooted in high operating costs and raises the temptation to charge borrowers as much as possible. Low efficiency in this sector is also the result of poor competition and the relative neglect of lending to the corporate sector (as the alternative, for years, has been buying highly yielding government bills).

There is a long way to go in reducing real interest rates; the process will go along with deeper restructuring in the real economy and a better business climate (which would reduce risk premiums) and with more competition in the banking industry, in the financial industry in general (where banks will have to compete with non-banking financial institutions).

**Fig. 3. Interest rate spread, non-banking customers**

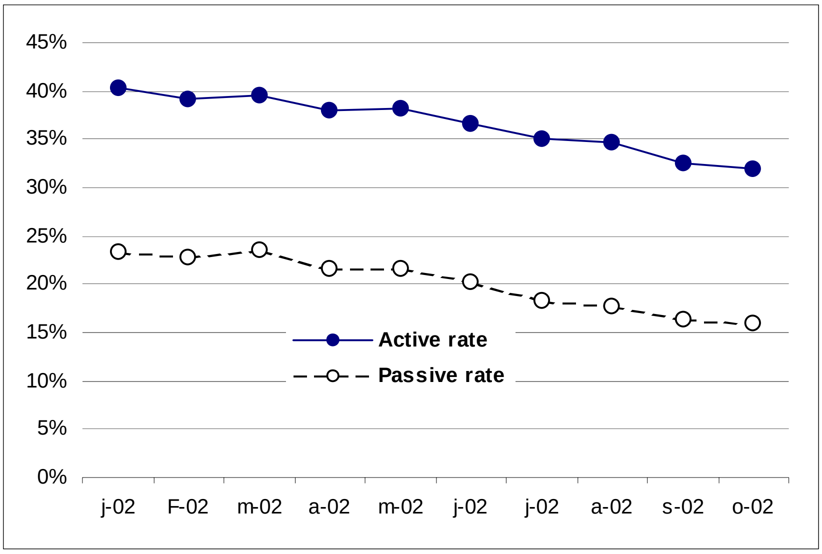
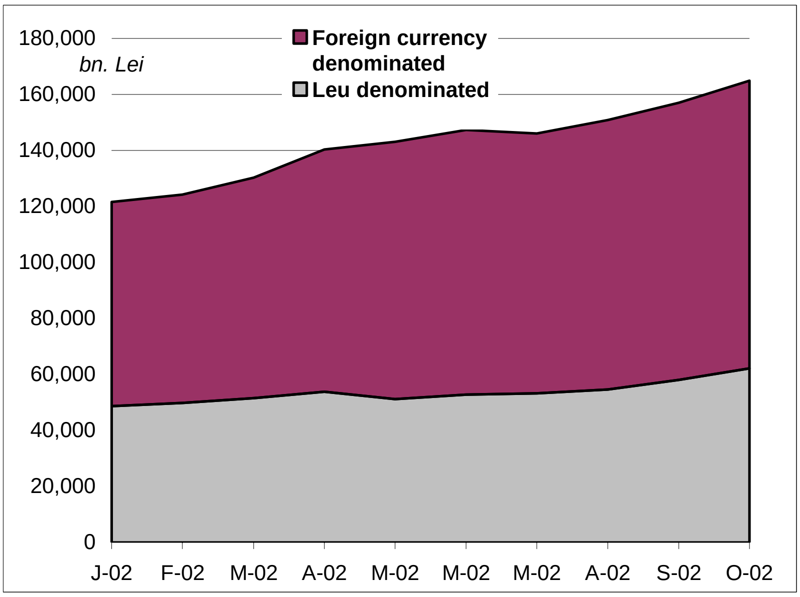



**Fig. 4. Non-governmental domestic credit**




## EXCHANGE RATE POLICY AND PRODUCTIVITY GAINS

Preliminary figures indicate better external accounts (both the trade and the current account balances) for Romania in 2002, in spite of ROL's real appreciation against a currency basket (made up of 60% Euro, 40% USD). There have been favorable influences which lie behind this situation: the Euro's sharp appreciation vs the US dollar (which bolstered the revenues of EU oriented exporters) and the remarkable surge in private remittances from abroad (which may have surpassed $1.4 billion in 2002). As a matter of fact Romania has become a large exporter of labor force, which includes both highly skilled and less skilled workers. Another positive influence could be the "learning curve" of Romanian companies translated in an increased ability to export.

The less rosy side of the story is that the structure of exports is skewed**,** seemingly increasingly**,** towards low value added products: textiles, footware and furniture make up almost 50% of exports. This would not be necessarily bad unless it relied, primarily, on labor cost motives. Are these exports resilient? An optimistic answer would underline their rise despite the economic slowdown in the Euroland and the US. A pessimistic answer would argue that, always, cheaper labor can be found elsewhere. The bottom line is that Romania has to find and develop its export niches and strive to climb the ladder of higher valued added exports. There are some studies which seem to suggest that FDI does play a positive role in upgrading Romanian exports (see the accompanying analysis on FDI in this report). But, the rising share of textiles, footwear and furniture in. EU oriented exports should not be taken lightly. Does the Government have a role to play to this end? Supposedly it does, in one way or another. From this perspective, NBR's policy of ROL real appreciation has to keep a keen eye on productivity gains in the manufacturing sector. Arguably, it would be a myopic strategy to overlook this linkage by betting on a steadily increasing flow of remittances from abroad and Romania's turning into a major tourism destination. It would be good for both these to happen, but policy-making cannot rely on optimistic scenarios only; contingency plans need to be always put in place. On this line of reasoning one comes to the capital account liberalization.

## III. CAPITAL ACCOUNT LIBERALIZATION (KAL)

The EU imposes on all candidates to open their capital account by the time of accession, but makes no specific demands on the speed and procedures to pursue. In 2001 Romania, unilaterally, committed itself to liberalize movements of capital, practically, by 2004 – well in advance of its prospective date for EU accession. According to the current timetable, KAL is sequenced over the next two years, with only two exceptions – one regarding specific money market instruments, and another[5] one regarding inward land purchasing by foreigners (see figure 5). Although the effort to catch up with other candidate countries is laudable, the KAL decision begs very serious and responsible examination in view of its possible, less benign, consequences[6].

Following the series of wild financial and currency crises worldwide, during the last decade, there is, currently, a wide consensus among economists that the full opening of the capital account should not be hastened (premature) in emerging economies; that major prerequisites for liberalization of capital transactions are the existence of a solid growth-supporting macroeconomic framework, the elimination of major structural imbalances and the functioning

---

[6] Issue highlighted previously in EWR. A thorough analysis of KAL in the case of Romania is: Daniel Daianu, Ion Dragulin, Liviu Voinea, Radu Vranceanu, *Opening Romania's Capital Account-An Optimal Approach* Bucharest, Romanian European Institute, 2002 (www.ier.ro)

of a healthy and tested operational and regulatory framework of the financial system. It is fair to say that Romania has improved considerably its economic performance in the last couple of years and a series of indicators look quite good: the overall public debt is low (below 30% of GDP); the domestic public debt is only 8% of GDP and its financing is done increasingly at longer maturities; the external indebtedness of the country is low (below 30% of GDP); the reserves of the NBR amount to around 5 months of imports; the share of external short term finance of public external debt is low; etc. On this ground one might try to justify the decision to open the capital account at a swift pace.

**Romania is still vulnerable to sudden capital movements, which call for a more cautious sequencing of capital account liberalization**

*But Romania still has major KAL-related vulnerabilities, which should make public authorities more cautious and, eventually, prompt them to review the current sequencing of KAL.* Inflation is still high; there is a very low level of monetization and financial intermediation, which makes wide swings of capital flows highly disturbing and sterilization operations (by the NBR) very costly; there is insufficient restructuring in the real sector and poor governance at the enterprise level, which create inflationary pressures and strain the public budget; there is still weak law enforcement in the financial sector and the new prudential rules are still to be tested; and low profitability and efficiency of banks. On account of these traits of the economy one can imagine scenarios of sharp rises in the prices of domestic assets (bubbles), following substantial speculative capital inflows (stimulated by ROL's real appreciation), which may create instability; reckless internal and external over-indebtedness of local firms and municipalities may also ensue, which would be quite threatening in view of the still soft budget constraints operating in Romania; the trade deficit may grow again sharply, abetted also by the real appreciation of the leu, while it is not solid-proof that the currently growing transfers from abroad would not stop, or even decline, as a consequence of possible international adverse circumstances (like Israel's tougher policy on illegal foreign workers in recent months).

There is another KAL-related issue, which should concern policy-makers to the utmost. Full KAL cripples or even annuls the ability of public authorities to conduct an autonomous monetary policy while they try to achieve some stability of the exchange rate. In the latter case the burden of macroeconomic adjustment would fall overwhelmingly on budget policy and a deflationary bias may very likely be imparted to its stance. In order to restore some autonomy to monetary policy a free floating of the exchange rate would have to be practiced, but this could be highly destabilizing itself and could require extremely restrictive monetary policy (following sharp depreciation of the exchange rate). Is the Romanian economy ready to accept the consequences of full KAL from this perspective, of a much smaller room of maneuver for macroeconomic policy? This question is even more relevant when taking into consideration the likely time of Romania's accession into the EU. This is why the "look good" indicators, mentioned above, and the confidence that some have in the ability of Romania to rely increasingly on remittances from abroad and revenues from tourism do not warrant complacency.

Arguably, policy-makers would be well advised to reexamine, in practical terms, the current KAL program, considering the need to make an effective preference for long term flows against short term flows (the liberalization of short term flows should be accompanied by adequate prudential measures); the need to make effective preference for capital inflows against capital outflows; and the need to avoid an undifferentiated and complete liberalization of capital inflows. Likewise, more attention should be given to the principle of contingency: actual liberalization should proceed only when well-defined macroeconomic and structural conditions and criteria are fulfilled.

Among concrete measures to "shape" the composition of flows policy-makers might consider: impose unremunerated reserve requirements (URR) for short term investment or credit taken in foreign currency[7]; the NBR could practice a system of discriminatory reserve requirements on foreign exchange deposits of banks; restrictions on corporate and public sectors' short term (less than one year) credits from banks and financial institutions located abroad; not allow banks to use short term debt instruments (T-bills, corporate debt, local state debt instruments) as a collateral for borrowing in foreign exchange abroad; maintain the requirement of NBR's authorization for any short term financial credits and loans, and guarantees of the corporate sector (the authorization should be given based on combined criteria, such as a clear improvement in the arrears record, on a case by case basis); support the creation of an independent rating agency for Romanian corporate and municipalities' debt instruments; keep purchase abroad of bonds, shares and other securities, dealt and not dealt on foreign capital markets, subject to authorization by the competent supervisory body etc.

Since the EU does not impose on Romania a timetable for its full KAL, readjustments of the program can be operated. It would be also wise for the Government and the NBR to consult with IFIs' experts (from both IMF and World Bank) on the sequencing of KAL, since this is a matter of utmost importance for the rules of functioning of the economy. As to the IMF, this specific item of consultation would be more than timely and appropriate for its work in Romania.

[7] In November, last year, Russia adopted such a measure as a means to discourage short-term, speculative, inflows. This measure is advocated by Daianu et.al (Op.cit)

## Fig. 5. NBR's KAL timetable

| Type of capital flows | Type of operations | Status of liberalization |
|---|---|---|
| By capital nature (maturity) | | |
| Long term flows | Direct investments, inward and outward* | Free |
| | Real estate investments, inward and outward* | Free |
| | Purchase of land by non-residents | Subject of derogation after EU accession |
| | Financial loans and credits, granted by residents to non-residents and by non-residents to residents, with maturity over 1 year | Free |
| | Sales and issue of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free |
| | Purchase of bonds, shares and other securities by non-residents, irrespective of maturity | Free |
| | Purchase of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free from 1.01.2003 |
| | Sales and issue locally of bonds, shares and other securities dealt on the capital market, by non-residents, irrespective of maturity | Free from 1.01.2004 |
| Short term flows | Financial loans and credits, granted by residents to non-residents and by non-residents to residents, with maturity less than 1 year | Subject of NBR authorization, except for banks, free from 1.01.2003 |
| | Commercial credits related to international commercial transactions, by residents to non-residents and by non-residents to residents | Free |
| | Guarantees by non-residents to residents | Free |
| | Guarantees by residents to non-residents | Free from 1.01.2003 |
| | Sales and issue of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free |
| | Purchase of bonds, shares and other securities by non-residents, irrespective of maturity | Free |
| | Purchase of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free from 1.01.2003 |
| | Sales and issue locally of bonds, shares and other securities dealt on the capital market, by non-residents, irrespective of maturity | Free from 1.01.2004 |
| | Personal capital transfers** | Free |
| | Personal loans and credits granted by residents to non-residents | Free from 1.01.2003 |
| | Transfers in performance of insurance contracts | Free |
| | Operations in Lei deposit accounts opened by non-residents | Free from 1.01.2004 |
| | Operations in deposits abroad by residents | No later than accession |
| | Physical import and export of financial assets | Free, except for cash; cash payments free from 1.01.2004 |
| | Sales, issue, purchase of securities and other instruments dealt on the money market, by residents and non-residents | No later than accession |

| By capital destination | | |
|---|---|---|
| Capital inflows | Inward direct and real investment* | Free |
| | Purchase of land by non-residents | Subject of derogation after EU accession |
| | Financial loans and credits granted by non-residents to residents, maturity more than 1 year | Free |
| | Financial loans and credits granted by non-residents to residents, maturity less than 1 year | Subject of NBR authorization, except for banks, free from 1.01.2003 |
| | Commercial credits granted by non-residents to residents | Free |
| | Guarantees by non-residents to residents | Free |
| | Sales and issue of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free |
| | Purchase of bonds, shares and other securities dealt on the capital market, by non-residents, irrespective of maturity | Free |
| | Personal capital transfers | Free |
| | Transfers in performance of insurance contracts | Free |
| | Physical import of financial assets | Free, except for cash; cash payments free from 1.01.2004 |
| | Purchase of securities and other instruments dealt on the money market, by non-residents | No later than accession |
| | Sales and issue of securities and other instruments dealt on the money market, by residents | No later than accession |
| Capital outflows | Outward direct and real estate investment | Free |
| | Financial loans and credits granted by residents to non-residents, maturity more than 1 year | Free |
| | Financial loans and credits granted by residents to non-residents, maturity less than 1 year | Subject of NBR authorization, except for banks, free from 1.01.2003 |
| | Commercial credits granted by residents to non-residents | Free |
| | Guarantees by residents to non-residents | Free from 1.01.2003 |
| | Purchase of bonds, shares and other securities dealt on the capital market, by residents, irrespective of maturity | Free from 1.01.2003 |
| | Sales and issue locally of bonds, shares and other securities dealt on the capital market, by non-residents, irrespective of maturity | Free from 1.01.2004 |
| | Personal capital transfers | Free |
| | Personal loans and credit granted by residents to non-residents | Free from 1.01.2003 |
| | Transfers in performance of insurance contracts | Free |
| | Physical exports of financial assets | Free, except for cash; cash payments free from 1.01.2004 |
| | Operations in deposits abroad by residents | No later than accession |
| | Sale and issue of securities and other instruments dealt on the money market, by non-residents | No later than accession |
| | Purchase of securities and other instruments dealt on the money market, by residents | No later than accession |

# FDI IN ROMANIA MATURES

*Liviu Voinea*

TRENDS

Foreign direct investment (FDI) in Romania (and possibly elsewhere) is like wine: it has to mature to make a better impression. Not all wine bottles are collection items; also, not all FDIs make the same impact. This article suggests that a critical mass of FDI has been reached on a sector-by-sector case; and that FDI represents a major channel of technology transfer contributing to overall economic development. Whether or not it also contributes to the development of local capital firms – this is a distinct question, not to be tackled here (a working hypothesis could be that positive spillovers on local firms also occur on a sector-by-sector case).

Except for 1998, FDI in Romania has never been impressive (Fig. 6). The total inward FDI stock, in the period 1989-2002, is rather moderate: slightly over $8.5 bn. (about 20% of GDP); other transition economies performed better in gross and relative terms. The annual net FDI inflows, even in 2002, are below the level of foreign remittances, and barely cover for three weeks of imports; top 1% of foreign investors account for 80% of total foreign investment.

**Fig. 6. FDI evolution**

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FDI, USD mil. | 37 | 73 | 87 | 341 | 417 | 263 | 1224 | 2040 | 1007 | 1051 | 1154 | 823 |
| FDI, % GDP | 0.1 | 0.3 | 0.3 | 1.1 | 1.1 | 0.7 | 3.4 | 4.9 | 2.9 | 2.9 | 3.0 | 2.6 |
| FDI, % current acct deficit | 3.6 | 4.6 | 7.4 | 79.6 | 23.5 | 10.2 | 57.5 | 68.7 | 78.1 | 77.1 | 49.1 | 73.8 |
| FDI, % total net capital inflows | 1.9 | 3.4 | 6.0 | 12.7 | 26 | 7.3 | 36 | 89 | 124 | 27 | 28 | 25 |

One of the studies that pioneered the analysis of FDI in Romania[8] noted that FDI had limited strenght – and, hence, significance – in the Romanian economy; the study was however based**,** primarily, on year 1998 data. One conclusion was nevertheless drawn: foreign firms outclassed local firms – state and private alike – with respect to labor productivity, investment to turnover ratio and profitability.

A recent paper based on year 2000 data, pictured a sharp rise in FDI penetration in the Romanian economy. FDI accounted then for almost half of the equity capital, half of the export sales, one quarter of the employees and more than one third of the turnover in the manufacturing industry (the current ratios are probably even higher)[9]. The authors of that paper observed that Romania almost caught up, in terms of FDI penetration, with the first wave of transition economies, as the level of FDI penetration in the Romanian

[8] Boscaiu Voicu, Costea Munteanu, Daniela Liusnea, Lucia Puscoi (2000), *The impact of FDI on productivity in the Romanian manufacturing industry*, RCEP Working paper 22.

[9] Irina Dumitriu, Gabor Hunya (2002), *Economic restructuring through FDI in Romania*, paper presented at the 7th EACES (European Association for Comparative Economic Studies) conference, Bologna.

economy in 2000 was similar to that recorded in Czech Republic, Hungary and Poland in 1999. Romania's export specialization – authors say – shows striking similarities with the significance of FDI by manufacturing industries, and Romanian export sectors can stay successful due to continuing foreign penetration bringing in technology and providing market access. Romania is considered to have joined the development path described by „the flying geese paradigm". The role of the leading goose is played by the EU, while Romania follows with low-technology labor intensive products; these products are upgrading as new stages of FDI lead to further specialization.

The link between FDI and technology transfer in the Romanian economy is validated from different sources. A fresh new study on FDI spillovers in Central and Eastern Europe[10] finds that FDI is an important direct channel for the transfer of technology to foreign owned companies located in Romania (the same goes for Czech Republic, Estonia, Poland, and Slovenia, but not for Hungary and Slovakia). Furthermore, in Romania, the R&D activities are basically concentrated in foreign firms (as in Bulgaria, Czech Republic, Estonia, Slovakia, but not Hungary and Slovenia). According to the study, Romania has the highest contribution of foreign ownership to the average growth rate of firms, due to the transfer of productivity-enhancing new technologies. Qualitative data (Global Competitiveness Report 2002) also reveals that local companies obtain technology from licensing or newly established foreign firms, rather than by conducting formal research and innovating new products and processes.

Technology transfer is related to rising imports, in the first stage of investment. Indeed, another paper[11] found a significant positive correlation between FDI and the trade deficit in Romania over the last twelve years. This is concordant with the general behaviour of foreign investors of replacing local suppliers by foreign ones, when the technological gap is large. However, competitiveness gains due to these technology transfers are supposed to enhance exports incorporating higher value-added; trade deficit should not be a matter of concern, as FDI tends to substitute imports, at a later stage.

Everyone is familiar with the image of foreign investors coming to Romania due to cheap labor. But the technology transfer adds more color to this image. Textile products, footwear and furniture are traditional labor intensive sectors, with an important foreign capital penetration; they account for one third of all employees in the manufacturing industry and for more than half of total exports to the EU (Romania is in fact EU's third largest supplier of textile products and importer of textile fibres). Nevertheless, according to official estimations, 85% of producers own and use modern technology. The result was declining unit labor costs (productivity grew faster than wages) and rising revealed comparative advantages (faster increase in the ratio between specific exports and imports, compared to the ratio between total exports and imports) in these industries over the last three years.

---

[10] Jose Damijan, Boris Majcen, Mark Knell, Matija Rojec (2002), *The role of FDI, absorptive capacity and trade in transferring technology to transition countries*, manuscript.

[11] Liviu Voinea (2002), *Revisiting FDI patterns in transition. The case of Romania*, paper presented at the 7th EACES conference, Bologna.

The sectors dominated by foreign investments show higher specialization than the other sectors, reflected in the upward trend of the intra-industry index Food and beverages, machines and equipment, means of transportation, cement, metallurgy – they all show improving intra-industry indexes (IIT, showing higher specialization within an industry) now, compared to the situation before foreign investors appeared and consolidated in these sectors.

### Fig. 7. Regaining competitiveness in textiles

| | 1998 | 1999 | 2000 | 2001 | 2002-I |
|---|---|---|---|---|---|
| Unit labor costs | 0.37 | 0.34 | 0.24 | 0.19 | 0.18 |

### Fig. 8. Increasing specialization in selected FDI-driven sectors

| | Food and beverages | Metallurgy | Machines and equipment | Means of transport. |
|---|---|---|---|---|
| Intra-industry index 1993 | 0.34 | 0.80 | 0.28 | 0.45 |
| IIT 2002-semI | 0.39 | 0.93 | 0.77 | 0.79 |

Moreover, food and beverages, mettalurgy and road transportation means recorded the highest output growth and the largest productivity gains in all manufacturing industries. The *Early Warning Report 6/2002* already remarked that the best performing sectors in 2002, the real productive engines of the economy, were those dominated by foreign capital.

Another positive development related to FDI is the recent surge in greenfield investments. According to the state privatization agency's report for 2002, revenues in 2002 were 84.8 mil. USD, and further 250 mil. USD were committed in investments (only partly undertaken in the same year); most buyers were local investors. At an annual volume of FDI around 1 bn. USD, it means that almost 9 out of 10 dollars in FDI in Romania over the last year came through greenfield investments. Earlier ratios were much inferior (between 50 and 60%, according to *EBRD Report 2001* and *WIIW Database 2001*). This confirms the forecast made in the *Annual Early Warning Report 2001*, that a new generation of FDI based on greenfield investments is likely to replace much of the privatization-related FDI flows.

FDI penetration, on a sector-by-sector basis, is remarkably increasing, contributing to the transfer of technology and hence to the increase in intra-industry specialization. 2001 and 2002 were the years when the privatization related FDI made in 1997-1999 started to pay off, and new greenfield investments were rapidly rising. 2002 was even the first year when FDI-driven sectors were one of the major sources of economic growth. The prospects in this respect are encouraging**,** but risks remain in the area of inneficient anti-trust policy**.** Governmanetal policies should also be more supportive towards companies that undertake R&D activities locally, to enhance further integration of various production stages of foreign firms taking place within their Romanian affiliate.

# POLITICS

## S.O.S. BUCHAREST
### Political bickering leaves the Romanian capital ungovernable

*by Sorin Ioniță*

WARNING

All politics is local, they often say in the USA. But it has seldom been more true than in Bucharest, Romania these days. The capital city of the second-largest EU candidate country, a booming (by local standards) and expanding metropolis inhabited by 9% of Romania's population, but pumping out almost 20% of Romania's GDP, has been mired in the last two years in a string of political scandals and incoherent administrative decisions that made it almost ungovernable. For most part, Bucharest has become the fighting ground between the national government of the Social Democrat Party (PSD) and the opposition Democratic Party (PD), headed by the larger-than-life figure of the mayor-general, Traian Băsescu. The situation is complicated politically by two factors: (i) in the 2000 local elections PSD won the majority in the General Council of Bucharest, as well as the 6 district councils and the 6 district mayor offices; but spectacularly lost the office of General Mayor; (ii) the current General Mayor Băsescu is believed to be one of the main contenders for the office of Prime Minister in the 2004 elections, so as a result many of his actions are not necessarily meant to achieve local results but national visibility, and portray him as the most important opponent of the government.

**In 2002 the tension and confusion increased after the government moved to dissolve the General Council**

While these political rivalries have their roots in the aftermath of the 2000 elections, the tension has escalated substantially in 2002. The year started with a coup de theatre by the central government, when a report by the newly appointed head of the internal inspection unit of the premier was released to the press in January. The document was the result of a control in the Bucharest local government, and revealed a consistent pattern of procurement irregularities and conflict of interest involving top local officials. Some public managers and civil servants, as well as mayor Băsescu himself, were mentioned in connection with various irregularities. But the report focused mainly on the General Council members – politicians elected on party list for the Bucharest higher legislature. Of the 65 councilors, 38 were found to have business interests in various private companies, more than half of the latter in firms doing business with the Bucharest local government proper.

The report helped to make the moral case for the subsequent moves made by the central government, with uncharacteristic speed and decisiveness. Taking advantage of a technicality in the law (any local council can be dissolved if three of more of its decisions were overturned in administrative court in less than six months), the government announced the termination of the General Council, and that early elections would be held in Bucharest as soon as possible. According to the central government, this extreme measure had to be taken because the local councilors had previously argued that the provisions regarding conflict of interests in the new local governments law were inapplicable to them, since they had taken office before the law was passed in 2001. Nor was political control very successful in making them resign or give up their business interests: although most councilors incriminated in the report and exposed by the media were from the PSD ranks, they were members of the powerful municipal organization and had many supporters in the central party, and even the cabinet. Therefore, a legal shortcut was found to deal with a real problem that was damaging PSD's image and was affecting the credibility of the anti-corruption campaign.

However, as we warned in a previous material, it was unlikely that in a crisis trying to deal solely with the effects would eventually cure the problem – or that dissolving the General Council was going to be easy[12]. *Corruption and traffic of influence should be tackled with a clear set of laws to prevent conflict of interests and increase transparency and accountability, targeting the whole public sector in Romania, not only local governments* – the EWR argued at that time. Simply removing some elected officials from office does not guarantee that the next ones will behave differently as long as the rules of the game are the same. The provisions of the new Local Governments law, applicable to a newly elected council, may be a step in the right direction, but they are far from enough to rule out corruption in public office at the local level. Moreover, EWR predicted a long and tortuous legal battle between the Bucharest General Council and the central government, both dominated, curiously, by the same party (PSD).

Unfortunately, these anticipations were confirmed. A group of councillors from the opposition sued, and the case started to move slowly up through the court system. In an attempt to put moral pressure on their colleagues and force a speedy resolution of the issue, the rest of the opposition (PNL, PD and PRM) resigned from the council in the autumn of 2002 and did not nominate replacements, thus altering the composition of the body and leaving the ruling party with absolute majority in the council (Fig. 4). Had the PSD councillors done the same thing, following the initial political signal of the government, the matter would have been solved quickly and early elections could have been organized in Bucharest on the spot. Instead, they tacitly sympathised with the initiators of the legal action, and stayed put. Meanwhile, the high-level backers of the General Council had apparently prevailed, and as a result the central government lost its initial determination to dissolve the Bucharest General Council. The fight with the General Mayor Băsescu escalated and helped re-unite PSD around a common cause.

[12] Early Warning Report, no. 4/2002, UNDP/SAR, Bucharest, www.undp.ro, www.sar.org.ro

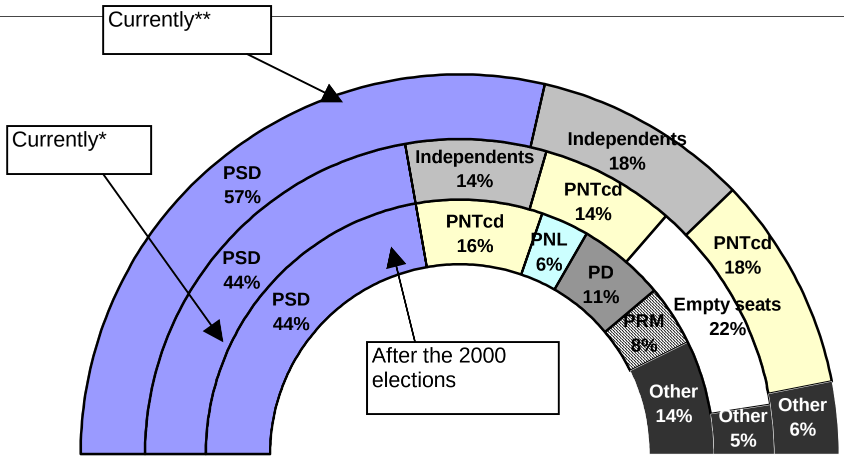



**Fig. 4. Dominant party rule: composition of the Bucharest General Council**

* As of Dec 2002, after various party swaps and the resignation of 15 councilors from PNL, PD and PRM
** As of Dec 2002, minus the empty seats that do not count for the quorum

A whole mismatch of political cleavages and contradictory decisions arose, which makes the situation hard to understand even for domestic observers:

- First, the central government decides to dissolve the General Council of Bucharest, allegedly because many councillors were trafficking influence; the legal basis of this action were 11 decisions of the General Council overturned in court (3 would have been enough). Most of them had been attacked precisely by the General Mayor Băsescu.
- Second, a small group of opposition councillors sue in court, and the government decision is suspended until a final pronouncement is made.
- Third, most PSD councillors tacitly support their colleagues who oppose the dissolution of the General Council, while the main opposition parties agree with the central government and try to speed up the process by withdrawing from the council. Mayor Băsescu declares that he is fully in favour of early elections and of the dismantlement of the corrupt General Council.
- Fourth, while a final decision in court was still pending, and taking advantage of their new super-majority[13], the PSD councillors began to

[13] Many independent councilors who have deserted their parties in the last two years vote regularly with PSD, in the hope of eventually joining it (Fig. 4).

enact forcefully some of the very decisions (11) initially suspended in administrative court, and which constituted the basis of the first move by the central government. Namely, they transferred many substantial local government functions from the municipal level to the six Bucharest districts, where PSD controls both the councils and the mayor offices. Paradoxically, in doing this they enjoyed full support from the central government, who apparently decided that scoring points against the General Mayor had become more important than dissolving the Council.

**Though largely ignored by parties so far, early elections in Bucharest are likely to be the most important political event in 2003**

However, a final decision by the Supreme Court is expected probably in February, and it is very likely that it will confirm previous pronouncements by the lower courts – namely, that the government's decision to dissolve the General Council of Bucharest was technically legal, and therefore it stands. Then, according to the law, the government has one month to announce the schedule of early elections in Bucharest, which means that they will most probably take place in April or May this year.

This being the case, it is surprising how little attention was devoted by all political parties to this issue. As the possibility of holding early elections nationwide in 2003 seems increasingly remote, the competition for Bucharest is likely to be the major political event of the year in Romania and a very good interim test of popularity for all political actors. No preparations have been made so far, and no action programs have been put forward for public consultation to deal in a coherent manner with the numerous problems that the Capital faces: poor infrastructure, sloppy public services, no general development plan (the latest dates from 1936), lack of transparency and accountability in using public funds. Moreover, the structure and status of the Bucharest local governments (one municipal, and six districtual) have been poorly defined in both post-communist Local Government Laws (adopted in 1991 and 2001, respectively). Bucharest has been treated like any other Romanian locality in terms of functions and revenues, though it is the only municipality with two-tier elected local government. The loose assimilation of the upper tier with counties, and lower tier with 'normal' localities, is not sufficient – it does not clarify the relationship between municipal and district institutions, and between those and the central government (primarily, the office of the prefect); and it tends to be disfunctional, because the arrangements necessary for managing a large city are different from those established between county councils and rural local governments, for example. An idea was circulated at the beginning of 2001, immediately after the current

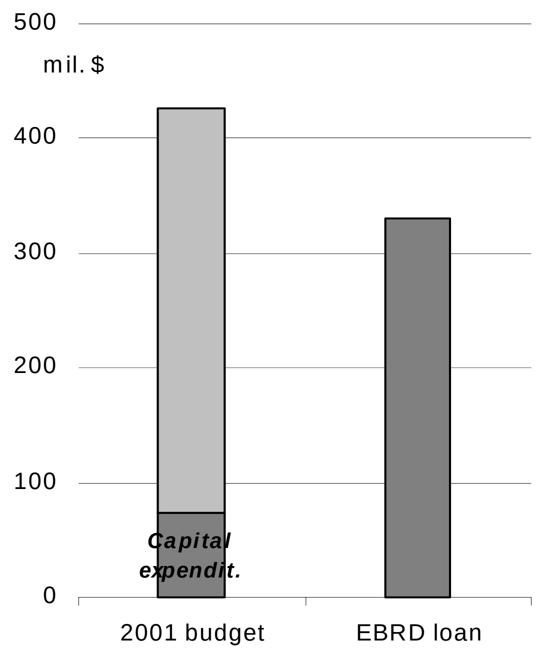



**Fig. 5. The size of the EBRD loan in dispute, compared with the Bucharest 2001 budget**

cabinet had taken office, to pass a special law for Bucharest. Unfortunately this potentially useful idea was subsequently dropped.

If anything, the situation deteriorated further in 2002. The most important point of contention became the $330 million loan from EBRD (110 million the loan proper and 220 million co-funding from the Romanian government (Fig. 5) for infrastructure rehabilitation. Though the five main projects to be financed had been previously approved by all the parts involved, the government subsequently joined the General Council majority and the district mayors in arguing that the destination has to be changed in order to match "the citizens' true priorities". The basis for this change of mind were "consultations" run by some district mayors; however, no figures or details were made public about these consultations, the methodology used or polling institutes taking part, if any. EBRD made it clear that the structure of its loan cannot be changed once approved, so the Ministry of Finance requested formally the cancellation of funds for three of the five projects. Since this happens almost one year into the financing period, it is still not clear what penalties should be paid for not using the funds for almost one of the five years of preferential conditions.

But there is much more to it than that. Less noticed went equally important decisions by the General Council of Bucharest, most of them passed in November-December 2002, rushed through before the foreseeable early local elections would terminate the PSD super-majority. The Office of Road Maintenance was dismantled at municipal level and six new such offices are to be set up at district level, as the corresponding attribution was passed down by the General Council. The problem is, the change is supposed to be effective beginning this January, which means that only a few weeks before holidays were available for organizing for such complex task. Another decision was to re-create the Offices for Housing Management at the district level (the famous ICRAL of the communist times), and to pass the residential property ownership and administration rights to the district local governments. The short period allowed for implementing such a monumental action make the measure impossible to be carried out as planned; for example, a very complex archive system has to be set up. But in all these cases a small detail was overlooked – that currently the Bucharest district local governments do not have juridical personality, which creates a whole set of problems when it comes to patrimony, property rights, or contractual relationship with non-public entities. They became apparent after the General Council decided a few months ago to decentralize to districts the privatization of commercial property owned by the municipality and earmarked for privatization. No results were reported so far, but anecdotal evidence suggests that the process is practically blocked by lack of capacity and legal uncertainties.

**Hasty decisions to transfer as much power as possible to the districts have led to the blocking of many municipal services – even at the district level**

The General Council's determination to alter substantially the structure of Bucharest local governments' functions produced a series of hasty and uncoordinated decisions that are difficult to enforce and make Bucharest practically unmanageable. Most of the energy in the Council was spent with the reallocation of functions and funds, but the same Council was far less bold and active in other respects, more related to the substantial administration of the city.

For example, although the new Law on Local Taxes coming into effect on January 1st 2003 was adopted almost one year ago (in one of the few cases when the central authorities were foresighted enough to give public institutions time to plan for implementation), all the district councils, mayors and their chief financial officers re-discovered it only in mid-December. A few days before holidays, they started frantically to pass internal norms of implementation and print forms for the use of the public (the law imposes a new methodology to assess the value of buildings), which fatally vary from one district to the other. As a result, the month of January is passing in confusion and the public will continue to form huge queues to pay their local taxes, while the district authorities' only suggestion is that they should not rush because "the early payment bonuses are too small to count". Since property tax is the main own revenue of local governments in Romania, and one that can still be improved a lot as far as fairness and total yield are concerned, it is their own self-interest, if not the respect for the taxpayer, that should have made Bucharest authorities to treat this issue with more attention. If at least 10% of the effort spent in political struggles at the local level in the past year would have been invested in analyzing and fine-tuning the property tax, the local governments would have collected more funds and the tax would have been set more rationally (at present it is highly regressive, which means that the higher the market value of your property, the less you pay as a percentage of this value).

On the other hand, the abrasiveness of General Mayor Băsescu and his determination to boycott the regular meetings with district mayors and the sessions of the Operative Consultative Unit (including the representatives of districts, relevant ministries, and the prefect), were not exactly helpful in improving the climate. His public calls to civic disobedience, by encouraging citizens to defer payments to the municipal heating utility, are hardly the kind of actions that bring coherence in the local government.

**Prefects (central government apointees) tend to assume much more attributions than those written in the Constitution**

Filling the void of authority, the Bucharest prefect has become increasingly assertive over the last months, taking part in inspections to outdoor markets during the December buying season and trying to enforce "fair prices" on sellers, organizing street cleaning, getting himself involved in contracting street repair works, or, recently, "issuing instructions" to Radet – the public heating company subordinated to the municipal authorities.

The only problem is, according to the law the Romanian prefects are not local government. As central government appointees, they have only attributions to check the legality of local government's decisions, sue them in court if necessary, and coordinate the emergency services in case of natural disaster. As a result, by much of what the Bucharest prefect has been doing lately he has been acting outside the limits of his legal authority. There is hardly anything new here: the Romanian unwritten administrative tradition has always accommodated central interventions in local affairs, even when they trespass the provisions of legal norms. However, there comes a time when such administrative relations have to be clarified, codified in workable laws, and obeyed by everybody, if the decentralization process is to produce the expected results in Romania.

We believe that the current crisis in the Bucharest local government can be sorted out, with beneficial effects on the welfare of the community in the long run, if certain **principles of reform** are followed:

- The hasty and politically-motivated reshaping of the Bucharest local government structure by General Council's decisions has to be halted, at least until new elections for the body are held. These decisions are poorly prepared, hard to implement and uncoordinated. Moreover, this council has lost moral authority (though, it is true, not the legal one) to adopt strategic decisions affecting the city, after it has been suspended by the government for corruption one year ago, lost all the preliminary decisions in court so far, and it is likely to be dissolved by the Supreme Court's final pronouncement in the coming months. There are many day-to-day operations at the municipality level that require the attention of the local councillors.

- The central government should revert to its initial intention to draft and circulate a *Bucharest Local Government Law*. It should organize consultations on this subject with all the stakeholders involved, including the new General Council that is likely to take office by the end of the first semester of 2003. And it should also consult independent experts, development partners and the main political parties. If it is agreed upon early and passed by Parliament in due time, the law should become effective only beginning with the 2004 local elections, to avoid problems of retroactivity. If the adoption is delayed, it should be implemented after the 2008 elections. It is more important to have a good law and stable expectations built on it rather than speedy but half-baked decisions.

- Very important, the law has to have organic character in relation to the political composition of the General Council, thus preventing the current situation when a local majority can alter substantially the nature of offices for which the citizens have voted. It is ironic that, after the local councillors argued based on the principle of non-retroactivity of laws and norms that the provisions of the new local government law dealing with conflict of interest do not apply in their case because they were already in office when the law was passed, they now make decisions that practically change the structure of elected offices at the local level, which have immediate application. Currently, there are no checks and balances at the local level provided for by the law, similar to those existing at the central level, to prevent winners from changing the rules of the game while in office.

- The office of the prefect is one of the most controversial public institutions in Romania. The government would be well advised to initiate a public debate on the status and attribution of prefects, in relation to its decentralization strategy. Historically, they have been around for one century and a half, representing the backbone of central control in the territory. Are they still necessary, once the courts and other non-executive agencies of the state become more experienced in exerting legislative control over local governments, and the emergency services are demilitarized and transferred to elected local institutions? Should their power be decreased in law – or, on the contrary, increased, thus practically formalizing something that is happening anyway? The current state of ambiguity is the worst option of all.

- No matter what the answers are to the previous point, the issue of the Bucharest prefect has to be addressed separately, most likely in the same *Bucharest Local Government Law.* Even if the counties will continue to have prefects, does Bucharest really need one? What should be his true responsibilities, since the capital is not a county but one single municipality? How can the impression be avoided that the Bucharest prefect is appointed by the government to shadow the actions of the General Mayor – the latter being elected directly by citizens – in other words, that central authorities try to govern the capital city against the citizens' will? The allocation of functions among the tiers of Bucharest local government, and their relationship with the prefect will have to be crystal-clear in the new law in order to avoid such situations in the future.

- The government should eventually make up their mind and explain publicly what they intend to achieve with the recently-announced plan to create and appoint *governors* in the 8 EU-type Development Regions of Romania. Is this new and powerful office supposed to supervise the use of all EU pre-accesion and accession funds, or just those which are spent by public institutions? Are they going to have informal power which is much broader than that, as is the case with prefects? What will be the nature of the relationship of these *super-prefects* with the elected local councils and mayors? The draft law circulated by the Ministry of Public Administration introduces clear elements of subordination of local councils to an unelected structure dominated by the governor (the Regional Council), who's decisions become mandatory for local governments in terms of projects to be implemented and contributions to the Regional Council's fund. And, most important: is Region 8 (Bucharest and its outskirts) going to have a governor too? What is she/he going to do, since the Bucharest prefect is already closely supervising (and meddling into) the affairs of the city capital? Until these questions are answered, any kind of reform plan is going to create more problems than it solves, especially when it is announced today only to be abandoned three days later, and reiterated again the following week.

- Finally, the conflict of interest has to be dealt with consistently – not only in the local administration, but across the whole Romanian public sector. There is no reason to suppose that the situation is worse in the first case than, say, in central government agencies. A clear and workable conflict of interests law has to be initiated that regulates the behaviour of all those who come in contact with public funds. For the local administration, the provisions in the new law (215/2001) are a good start, but they are far from being sufficient. The current regime has incredible loopholes: for example, even if councillors can no longer be managers (or board members) in a local public company, there is nothing that stops them from setting up a private firm to do business with their own local government – or, in case they want to be uncharacteristically discreet, set up the firm under the name of the spouse.

# SOCIAL

## ROMANIANS GO GLOBAL

## Patterns of migration and the European integration

*by Sebastian Lăzăroiu*

### TRENDS

One of the most debated topics during the last twelve years was the free movement of people and capital between EU members and candidates. In a world undergoing important changes due to the globalization process, labor force migration has lagged behind movement of capital and commodities. Acknowledging migration as an important source of development is badly needed nowadays. Money transfers from migration is twice the amount of financial aid given to developing countries, and often better targeted at the poor[14].

Migration flows from the candidate countries to the EU members are particularly significant in the context of enlargement. On the one hand, from an economic point of view these candidate countries are still located at the periphery, so that according to current migration theories[15] they should become sources of international migration. On the other hand the enlargement process itself is supposed to integrate these new members in the next decade, which means that current candidates will face the problem of migration and/or transit of people from Middle East, former Soviet Union countries and Africa. Migration flows from EU candidates to member countries, especially circulatory movements, will play an important part in speeding the enlargement process and lowering integration costs only if origin countries design institutions to properly manage labor force migration.

---

[14] Sorensen-Nyberg, Ninna, Van Hear, Nicholas, Enberg-Pedersen, Poul (2002), *The Migration-Development Nexus. Evidence and Policy Options*, IOM Migration Research, Series No 8

[15] Massey, Douglas S and others,(1993) *Theories of International Migration: A Review and Appraisal in Population and Development Review*, vol 19, Issue 3, pp 431-466

An ILO analysis on migration flows shows that between 1970 and 1990 the number of countries receiving foreign labor force increased from 39 to 67. In the same period the number of countries considered labor force reservoirs increased from 29 to 55. Another study pointed out that trafficking in migrants brings about 5-7 bil. USD each year. (Source: Press Release, ILO, 2000)

In 1998, 13 million, or 3.5% of the EU population was formed by migrants from developing countries, which means a 50% increase compared to 1985. A higher percentage was registered in Central Europe (Austria 9.3% and Germany 6.7%), while smaller figures are reported for southern countries (Spain and Italy). (Source: *Social Situation Report 2002*, EU)

During 15-20 years of free movement of people, between 1 to 2 million migrants from Czech Republic, Poland, Slovenia and Slovakia entered EU countries, which accounts for about 2% of these countries' total population and a yearly volume of 50-100,000 people (short-term mobility not included). (Source: The European Policy Center, *Eastward Enlargement and Migrations – getting it in perspective*, Dariusz Stola)

In order to prevent population decline and decrease the dependency ratio forecasted for the EU countries 615,000 immigrants are needed to compensate the deficit between 2000 and 2025, and 1.3 million migrants per year between 2025 and 2050. (Source: UN Report 2000: *Replacement Migration. Is it a Solution to Declining and Ageing Populations?*)

There was no free movement of people before 1989 in Romania. The communist regime had total control of citizens travelling abroad, and tourism was almost entirely oriented toward members of the communist block. Some labor force exchanges were possible with Arab countries and even the Western World, but only under careful scrutiny of the state. Emigration was encouraged only for "undesirable" citizens (dissidents and opponents of the communist regime), but it was by definition followed by social and political stigmatization of migrants and of their families left behind. Contacts between foreign and Romanian citizens were always under surveillance and this was part of the same policy of discouraging an exodus to the West. Besides long-distance migration, there was an accepted commercial exchange at the border area, all neighbors being also members of the communist block. The iron curtain between the developed West and the communist countries was the ultimate border to be transgressed by the Romanian citizens.

After the collapse of the communist regime in 1989, the new authorities proclaimed the freedom of movement of Romanians. However, the right to a passport proved insufficient to actually guarantee free circulation. In 1990 a significant number of people left the country for good (Romanian citizens with relatives abroad, but mostly Romanian citizens who were ethnic Hungarians, Jews and Germans). Shortly after that the Western countries imposed significant restrictions to Romanian citizens – and the visa was only one of them. A number of application criteria proved to be a real burden not only for tourists, but also for business travelers.

Once the consequences of economic restructuring appeared (high unemployment, living standard decline, increasing poverty rate, etc.) the most favored destination countries became nervous about a would-be exodus of labor from East-European countries toward the more developed capitalist world. The fear of criminal activities of illegal migrants added to a long list of concerns. It took a long time to abolish the visa requirements imposed to easternmost transition countries – Romania succeeded to fulfill the criteria only by the end of 2001.

Some important factors have contributed to visa elimination for Romanian citizens, such as:

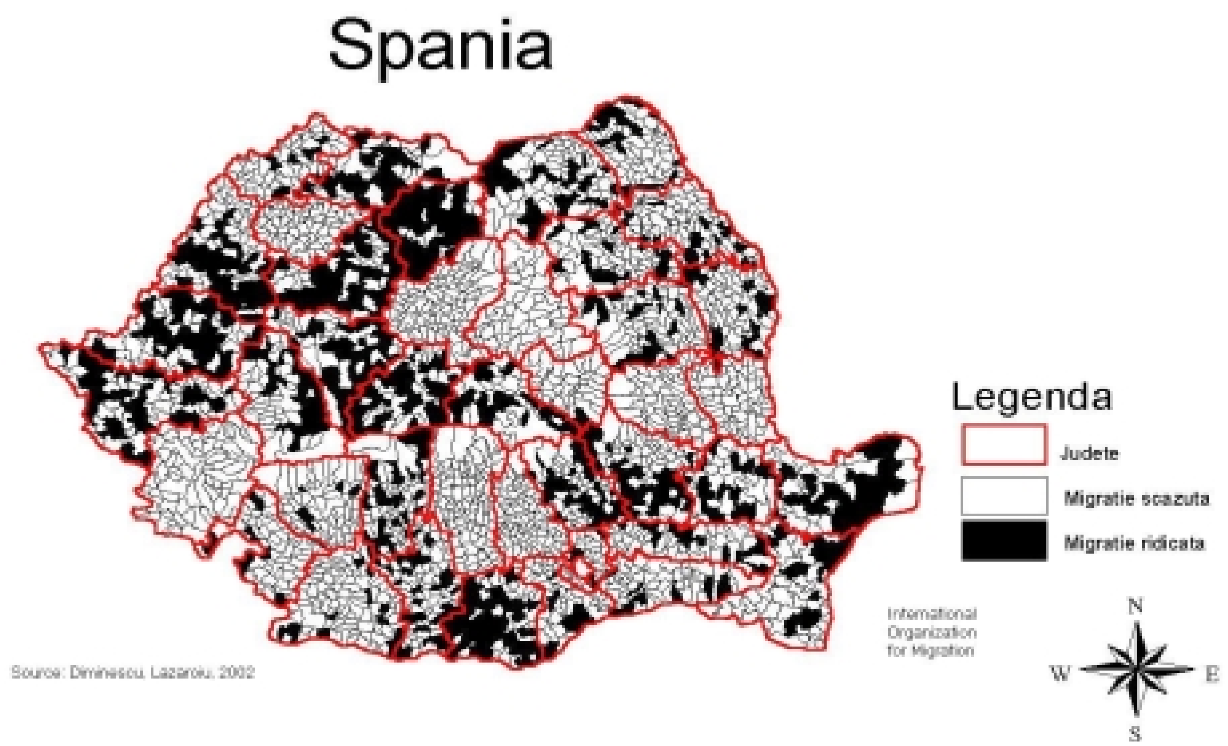
- The lobby of EU firms and entrepreneurs eager to recruit cheap and reliable labor from Eastern Europe
- The pressure of international organizations on EU members to honor the freedom of movement
- The actual presence of a large number of Romanian migrant workers (legal or not) in some Schengen states, which made visa restrictions superfluous
- Some irregularities among EU-countries consular offices in Bucharest, which made the screening of visa applicants erratic and unreliable
- The large number of economic agents mediating labor contracts between Romania and other EU countries
- The steps taken by the Romanian government to secure borders
- The improved institutional cooperation between law enforcement agencies from Romania and other EU countries
- The irreversible EU enlargement process.

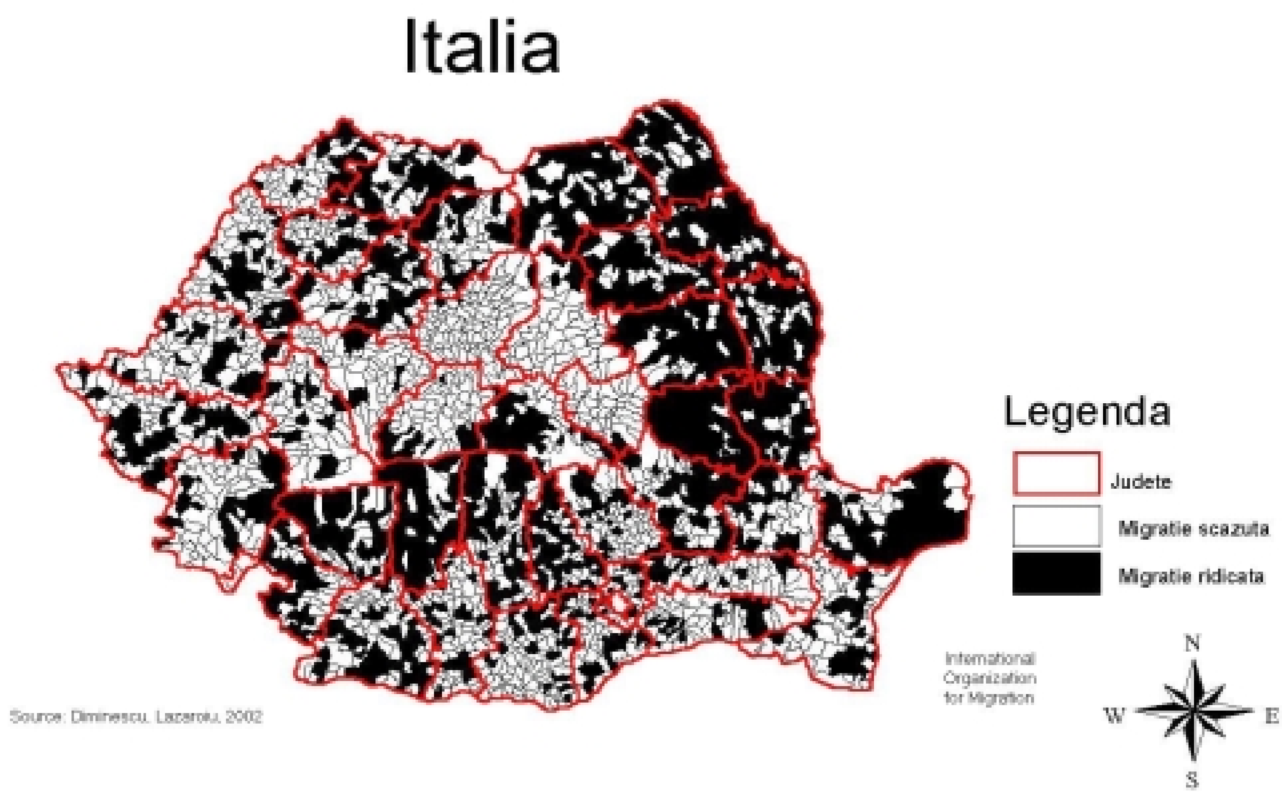
There are six types of systematic migration flows specific for Romania after 1990:

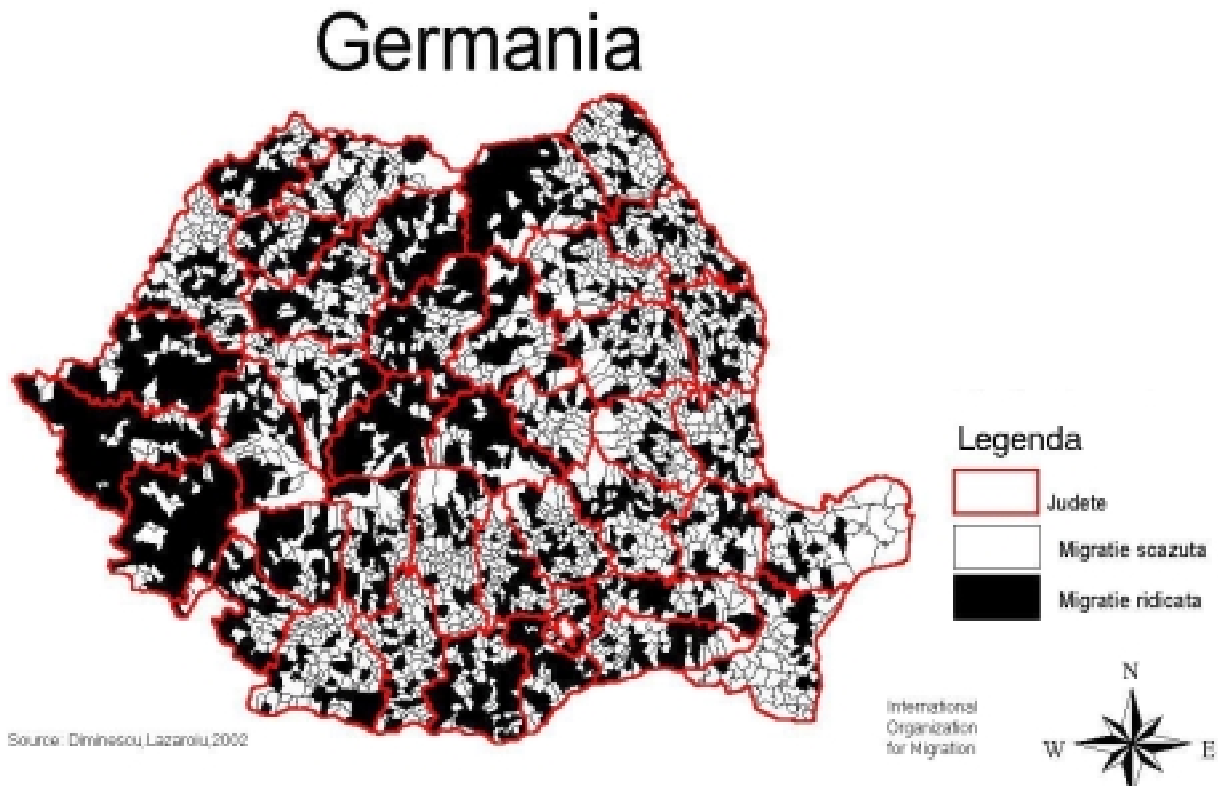
1. **Permanent emigration (changing residence and/or citizenship)**: ethnic groups (Germans, Jews, Hungarians), persons joining their family abroad and professionals (highly specialized personnel in IT who chose mainly Canada and the US as destinations).
2. **Circulatory migration of labor:** skilled or unskilled individuals who used recruitment firms or informal networks in order to enter EU labor markets, Yugoslavia, Turkey and Israel. Some of these migrant workers left the country based on a sure contract, others entered the destination countries as tourists and found jobs on the grey market. Once this back-and-forth flow reached a critical mass, some migrants received the final residence permit in the destination country and their families joined them.
3. **Student mobility:** students in degree or non-degree programs in European and US universities. Many of them extend their fellowships or take temporary contracts after graduation; some never come back.
4. **Commercial border exchange:** most visible on the border with Hungary and Yugoslavia. It peaked in certain periods (for example during the war in Yugoslavia, when breaking the embargo by the smuggling fuel and other goods was a lucrative occupation).

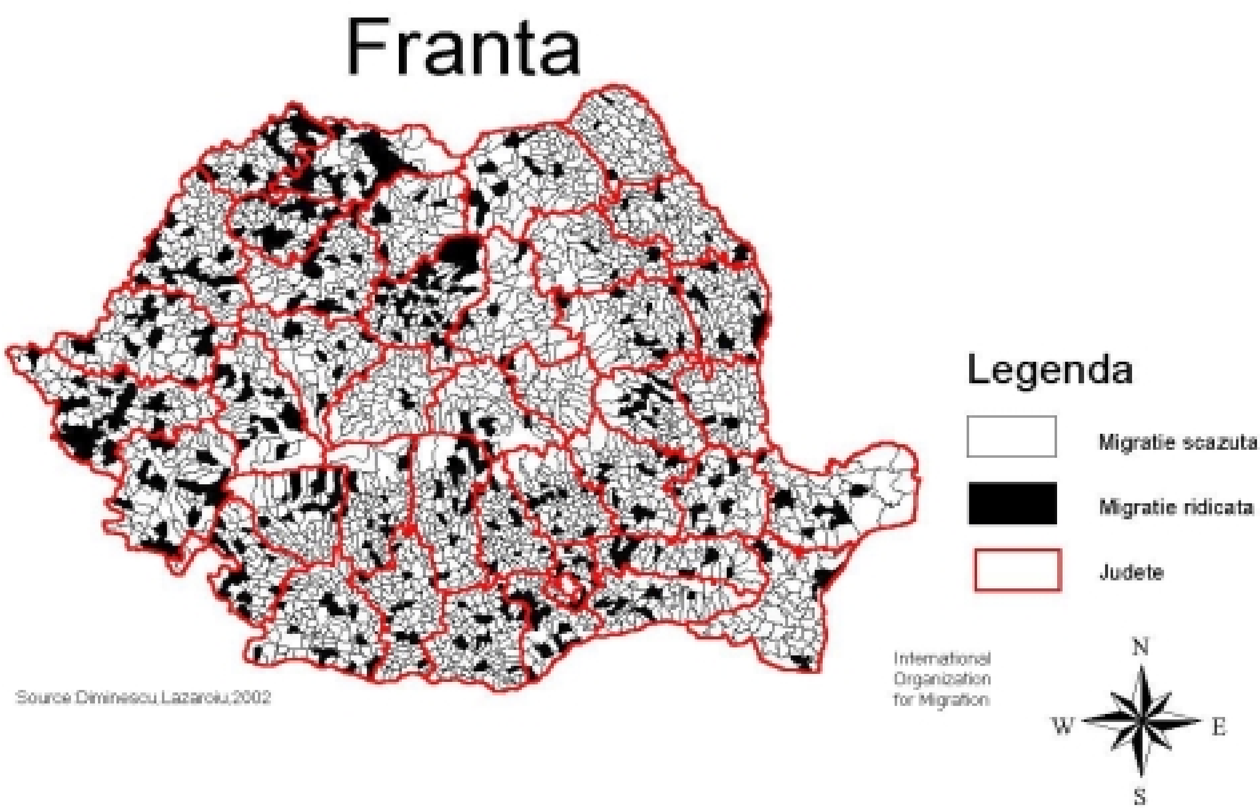
**Fig. 1 a-d. The main sources of circulatory migration, by country of destination: Spain, Italy, Germany, France**

**Legend: darkened areas represent the main suppliers of migrants**




Germania
Legenda
Judete
Migratie scazuta
Migratie ridicata
Source: Diminescu,Lazaroiu,2002
International Organization for Migration
N
W
E


Franta
Legenda
Migratie scazuta
Migratie ridicata
Judete
Source Diminescu,Lazaroiu,2002
International Organization for Migration
N
W
E
S

5. **Peddling:** individuals transporting small quantities of merchandise to/from Turkey, Hungary, and Poland.
6. **Organized and individual tourism:** people who travel on their own or through specialized agencies across Europe and other non-European countries. In some cases the tourist status was a camouflage for illegal labor migration.

Out of these categories, the circulatory migration seems to have the largest share in terms of volume and stability. While permanent emigration and peddling scored high figures in early nineties, they subsequently decreased to insignificant numbers, being replaced by circulatory legal and illegal migration. Circulatory movement is selective in the origin community, meaning that not all people chose to follow the same itinerary. Studies showed that young male, former industrial commuters (from rural to urban), ethnic (Rroma) and religious (Neo-Protestant) groups, and people from ethnically and religiously diverse communities were more likely to migrate in the initial phase. They are the "pioneers" of circulatory migration[16], persons who set up the migration networks thereafter used by new generations of migrant workers.

**Circulatory (temporary) migration predominates – and various communities have different preferred destinations**

The maps of migration indicate that destination countries depend on regional origin of the migrant (Fig. 1 a, b, c, d). Some destinations are more favored in certain regions of Romania, and therefore more community-concentrated. For instance Germany is the privileged destination in Western areas (Transylvannia, Banat and Crisana), while Italy is specific for Moldavian[17] communities. The distinction between network migration and irregular migration also accounts for the different destinations. The Saxons who left Romania and became German citizens kept strong relationships with their places of origin, which allowed the formation of organized migration networks. On the other hand in Moldova, where no such links existed, people choose Italy as favorite destination because it has less restrictive immigration policies.

### CAPITAL TRANSFERS

There are three types of capital transfers through the flow of circulatory migration: financial capital, human capital and social capital. As regards **financial capital,** an estimate for 2001 showed that about $1 billion was brought into Romania by migrant workers. The money comes in two forms: remittances and savings. Both are important because they help families in the origin countries to escape poverty or even make a decent living. Many studies show that a large share of the financial capital from migration is spent on consumption goods or invested in durable goods (like buildings and cars). Only a small share is invested in starting a business, even when circulatory migrants eventually come back for good. An even smaller share of the financial capital goes to community infrastructure. However, it is likely that

[16] Sandu, Dumitru (2000) *Migrația circulatorie ca strategie de viață*, in Sociologie Românească, serie noua, 2002

[17] In this report by Moldova we mean strictly the Romanian province situated in the eastern part of the country, not the former soviet Republic of Moldova.

after a few cycles of labor migration, some significant amount of money will go to private business.

**Human capital** transfers are sometimes more important in the long run than financial capital. It is often assumed that migrant workers acquire special skills abroad, especially when coming in contact with new technologies and management procedures. But it is not always the case, as most Romanian migrant workers perform unskilled jobs in the destination countries. Even when they do acquire special skills, it is unrealistic to expect that once back in Romania they will be able to use all these skills instantly, since technological transfer is slower, and motivation also plays a part. Still, there is a soft component of human capital that is beneficial to Romania, when transfers do occur: new languages, capitalist management and a certain work ethics that have been missing from Romania in the 45 years of communist regime.

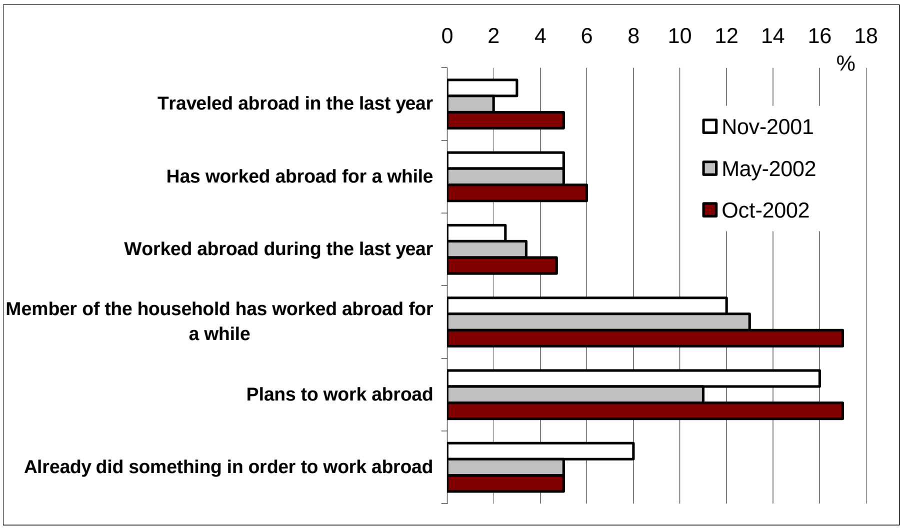
**Social capital transfer** is the least visible part, but a transfer of norms and values from the destination to origin countries does indeed take place. Learning a new language itself will increase the ability of migrants to connect to people from different cultures and thus form a bridge between the home and destination communities.

### ONE YEAR OF FREE MOVEMENT

It is interesting to note that in November 2001 only about 47% of the adult Romanians hoped that they would be able to travel to EU countries without a visa, one month before the decision was made to abolish visa restrictions for Romanian citizens. One year after, 55% of adult Romanians fear that visa restrictions may be reintroduced by the EU in response to the increasing concern of the Western public with the beggars and petty criminals coming from Romania. 64% of Romanians surveyed believe that there are certain categories of co-nationals who should be denied the right to leave the country since they create a bad image to all Romanians travelling abroad.

In spite of the initial concerns of the EU and Romanian authorities that a massive exodus of illegal migrant workers will follow the abolishment of visa restrictions for Romanians in January 2002, such fears have not materialized. Estimates in Fig. 2 show that there was only a slight increase in the number of those who traveled abroad in 2002 as compared to 2001. The same moderate increase characterizes the number of people who worked abroad in 2002 as compared to 2001. It is true that the absolute figure actually doubled, but the volume is still far from a labor exodus. Even in terms of intention to migrate for work the numbers before and after lifting visa restrictions display no significant variation. There is a constant share of about 16-17% of adults planning to find a job in a EU country. However, only 5% have already taken some action, which is the corresponding rate of labor migration after 1990. Fig. 2 also shows that about 17% of the Romanian households reported by the end of 2002 at least one member having worked abroad in the last 12 years. Highly selective migration in terms of gender and age accounts for the difference between the number of individuals and number of households reported. The usual pattern is when a man finds a job abroad and his wife, old parents and children stay home. Sometimes, in case of young couples, spouses migrate together.

**Fig. 2. Intention to migrate before and after the abolishion of visa restrictions** (% of total adult population)




*Source: Public Opinion Barometer – Open Society Foundation*

## CHANGING PATTERNS OF ROMANIAN MIGRATION AND FUTURE CHALLENGES

The patterns of migration from Romania have changed after the EU Commission's decision to abolish visa restrictions. We have to remember that the decision was made right after the Romanian authorities proved that they are fully able to control transit and domestic migrants. This means that more normative restrictions were imposed by Romanian authorities to Romanian migrants, including severe sanctions for illegal behaviour abroad (ranging from prison to restraining the right to travel abroad).

For legal migrant workers, or illegals who already belong to strong networks the EU decision at the end of 2001 had no significant effect. New irregular migrants will have a difficult time, because they have to limit themselves to short-term jobs only (3 months, the maximum duration of a tourist stay), then return to Romania and wait for the next opportunity.

**Tough anti-immigration rules keep illegals in, not out of, rich countries**

Different studies demonstrated that the favored destination for labor migration progressively changed after 1990, depending on how restrictive immigration policies became in the host countries. First was Germany, but in the last 3 or 4 years Spain and Italy became privileged destinations for Romanians. It is likely that more restrictive immigration policies will be enforced in the EU member countries and new Romanian migrants will choose as destination for migration some of the new EU members: Hungary, Czech Republic and Poland, as they are not yet prepared to control labor migration in their own market.

On the other hand, Western countries have started to understand the downside of a tough anti-immigration policy: the stricter you are, the more illegals you will have as a share of the total immigrants. Strict regimes make the circulation of workers costly in terms of money and effort to overcome (or by-pass) regulations. Therefore, they will be tempted to risk and stay as much as they can in the host country, because they cannot be sure that they will be able to come back later. As many surveys on immigrants into USA and Germany have demonstrated, tougher measures to reduce the number of foreign workers or asylum-seekers tend to increase the average period of stay, the proportion of illegals, and that of immigrants engaged in criminal activities (because of self-selection)[18].

There are countries in Southeast Asia, Central and South America, which explicitly design policies and institutions to export labor and import financial capital from their citizens overseas. Exporting labor has not been an explicit policy of the Romanian governments so far, and we do not believe that Romania should try to implement such an aggressive policy. However, when negotiating the free movement of persons chapter of the EU acquis the Romanian negotiators may wish to stress the points below:

- that migration can be good for both the host and the origin country,
- that a reasonably liberal regime may be more effective in controlling illegal activities than harsh anti-immigration measures,
- and that the poor and unskilled from Eastern Europe are the first who benefit from circulatory migration to work; indeed, this may be a more natural and effective way of helping Easterners close the development gap – not through financial aid managed by public institutions, but by allowing individuals to earn private money for themselves.

Finally, more is to be done at home in order to increase incentives for migrants to invest money in community infrastructure or business activities, and spend less on consumption. First and foremost, this is a matter of trust between the Romanian citizens and the state. As long as they do not see any improvement in public affairs and in the business climate, they will not be tempted to make risky and long term investments in Romania, other than those contributing to the immediate welfare of their family.

[18] A Survey of Migration, *The Economist*, November 2nd, 2002.

# THE AUTONOMY OF UNIVERSITIES UNDER THREAT

*by Bogdan Chirițoiu*

WARNING

The higher education system has been undergoing an explosive growth in the last few years. Now legitimate questions arise concerning the sustainability of this process, and compliance to quality standards. While rightfully trying to address these issues, the Ministry of Education has adopted or envisages some misguided and heavy-handed measures, which have backfired and have left the impression that its aim is to bring the academic world back under the financial control of the government. This article argues in favor of a different approach.

## LEARN, LEARN, LEARN!

Higher education has undergone a process of increased access in the last decade. The number of students has tripled, while the teaching staff has doubled. There was a strong increase in the number of universities, and an even stronger one in respect to the number of departments and disciplines, supported by the emergence of a significant private sector in higher education. The quantitative increase is the most dramatic of the features of the new higher education system. Romania has started the 1990s with one of the lowest higher education attendance rates in Europe. The number of students has substantially increased after 1989 (Fig. 3). It is now three times larger when compared with 1989. This trend was supported by the establishment of new universities (Fig. 4). An important contribution comes here from the development of the higher education private sector. The upward trend of the public sector has stalled from the mid 1990s. The number of public universities even went into decline. By contrast, the private sector registered sustained growth. The share of private sector students has stabilized close to 30% of all students.

Overall, the rate of higher education attendance[19] increased from 8% in 1989 to 22.2% in 1996 and 27.4% in 2001, when the total number of students has reached 533,152. Over the period the share of high school graduates moving to higher education increased from one-third to two thirds.

[19] The rate of higher education attendance represents the proportion of students in the relevant age cohort in a specific year.

### Fig. 3. Trends in the number of students, private education included

| Academic Year | Population in education ('000s) | Students | | |
|---|---|---|---|---|
| | | Number ('000s) | % | Growth factor (1989=1) |
| 1989/ 1990 | 5,545 | 165 | 3.0 | - |
| 1990/ 1991 | 5,066 | 193 | 3.8 | 1.2 |
| 1991/ 1992 | 4,805 | 215 | 4.5 | 1.3 |
| 1992/ 1993 | 4,665 | 236 | 5.1 | 1.4 |
| 1993/ 1994 | 4,569 | 361 | 7.9 | 2.2 |
| 1994/ 1995 | 4,595 | 369 | 8.0 | 2.2 |
| 1995/ 1996 | 4,703 | 336 | 7.1 | 2.0 |
| 1996/ 1997 | 4,688 | 354 | 7.6 | 2.1 |
| 1997/ 1998 | 4,643 | 360 | 7.8 | 2.2 |
| 1998/ 1999 | 4,631 | 407 | 8.7 | 2.5 |
| 1999/ 2000 | 4,578 | 452 | 9.8 | 2.7 |
| 2000/2001 | 4,562 | 533 | 11.6 | 3.2 |

*Source: INSSE*

### Fig. 4. Trends in the number of higher education institutions 1989 – 2000

| Academic Year | 1989 1990 | 1990 1991 | 1991 1992 | 1992 1993 | 1993 1994 | 1994 1995 | 1995 1996 | 1996 1997 | 1997 1998 | 1998 1999 | 1999 2000 | 2000 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| No. of state institutions | 43 | 48 | 56 | 62 | 63 | 63 | 59 | 58 | 57 | 57 | 58 | 59 |
| No. of private institutions | | | | | | | 39 | 44 | 49 | 54 | 63 | 67 |
| Total | | | | | | | 95 | 102 | 106 | 111 | 121 | 126 |

*Source: INSSE*

### Fig. 5. Participation to education (%)

| | 1995/1996 | 1996/1997 | 1997/1998 | 1998/1999 | 1999/2000 | 2000/2001 |
|---|---|---|---|---|---|---|
| Total | 64 | 64.7 | 65.1 | 66.3 | 67.3 | 68.9 |
| 3-6 years old | 63.6 | 65.5 | 67 | 68.5 | 69.5 | 66.1 |
| 7-10 years old | 96.9 | 96.7 | 94.4 | 95.8 | 95.5 | 94.2 |
| 11-14 years old | 92.8 | 94.3 | 98 | 98.1 | 96.9 | 95.5 |
| 15-18 years old | 59.7 | 61.1 | 61.6 | 63 | 65.9 | 74.6 |
| 19-23 years old and over | 22.7 | 23.8 | 23.5 | 25.2 | 27.2 | 30.4 |

**Fig. 6. Evolution of the number of departments and colleges**

| Academic Year | 1989 1990 | 1990 1991 | 1991 1992 | 1992 1993 | 1993 1994 | 1994 1995 | 1995 1996 | 1996 1997 | 1997 1998 | 1998 1999 | 1999 2000 | 2000 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Public | 101 | 186 | 257 | 261 | 262 | 262 | 318 | 324 | 324 | 361 | 411 | 438 |
| Private | | | | | | | 119 | 161 | 292 | 295 | 221 | 258 |
| Total | | | | | | | 437 | 485 | 516 | 556 | 632 | 696 |

### SHIFTING THE EMPHASIS

The picture is more complete if we look at the diversification in the specializations offered by the Romanian universities. This trend is expressed by data in Fig. 6, showing that the number of departments has increased quicker than the number of universities.

It is also interesting to analyze the dynamics among different specializations – presented in Fig. 6. With reference to state higher education, data show a decrease in the number of students enrolled in technical disciplines, in both absolute and relative terms. In contrast, the growth in student population is accounted for by the expansion of social sciences and humanities departments, which quadrupled their capacity. This trend is even more marked in the private sector. Data presented in Fig. 8 show a percentage of 75.4% of the students enrolled in economic and law studies in the academic year 1995/1996.

**Fig. 7. Trends in specializations: the rise of humanities**

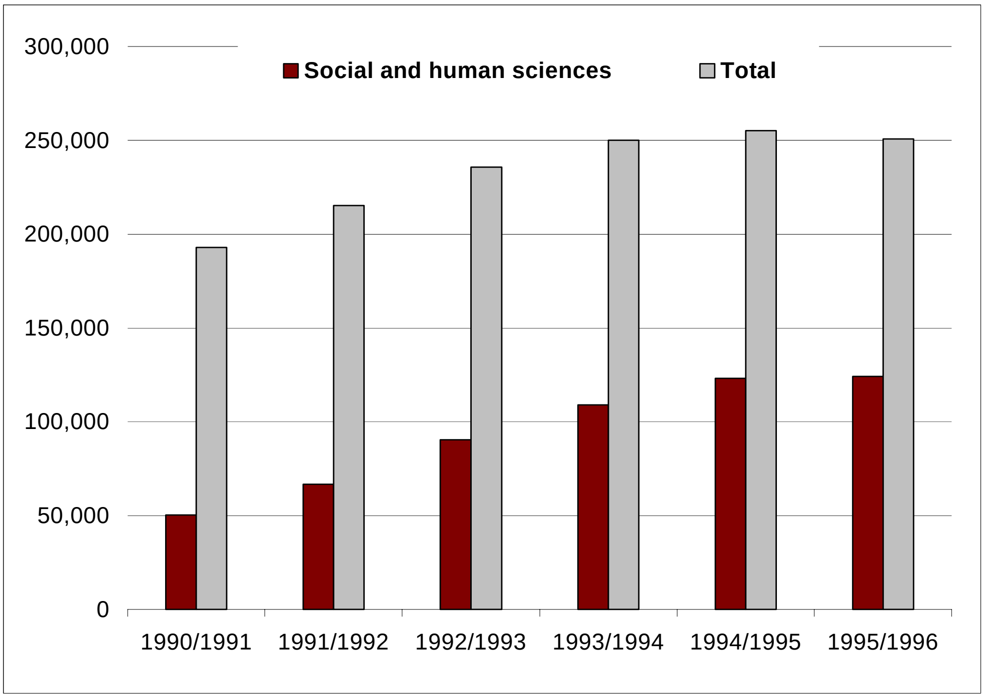


**Fig. 8. Students, by field of study**

| Fields of study | 90 91 | 91 92 | 92 93 | 93 94 | 94 95 | 95/96 | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | State | Private | State +private |
| 1. Economic studies | 10.4 | 11.5 | 15.0 | 15.9 | 18.7 | 20.6 | 37.8 | 24.9 |
| 2. Law studies | 2.1 | 3.5 | 4.6 | 5.9 | 6.1 | 4.4 | 37.6 | 12.8 |
| 3. University and pedagogical studies | 13.6 | 16.0 | 18.8 | 21.7 | 23.5 | 24.4 | 18.1 | 22.8 |
| 4. Technical studies | 62.5 | 57.5 | 50.1 | 44.4 | 39.5 | 37.6 | 0.1 | 28.1 |
| 5. Art studies | 1.0 | 1.4 | 1.5 | 1.7 | 1.9 | 2.1 | 0.6 | 1.7 |
| 6. Medical and pharmacy studies | 10.4 | 10.1 | 10.0 | 10.4 | 10.3 | 10.9 | 5.8 | 9.7 |
| Social and humanist sciences | 26.1 | 31.0 | 38.4 | 43.5 | 48.3 | 49.4 | 93.5 | 60.5 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

*Source: Mihailescu, 1996*

### LITTLE NEW RESOURCES

The increase in resources failed to keep pace with this expansion, which fuels concerns over the quality of the education process. Fig. 10 shows that in relative terms Romania is not a heavily taxing country. This largely ignored situation does not allow the government to pour enough resources in welfare policies. Accordingly, Fig. 9 is evidence that Romania under-spends on social items as compared to both EU and CEE countries.

The public spending on education increased after 1989. The shift that took place in public finances priorities in the early 1990s is illustrated by data in Fig. 11. Even so, education's share continued to stay below the mandated 4% of GDP, as provided in the Law of Education, article 169, and is one of the lowest in Europe. Coming from a minimum of 2.2% of GDP in 1989, the peak was reached in 1996, when the public expenditure on education was 3.6% of GDP. Moreover, the increase in percentage terms is not necessarily related to a higher absolute amount (due to the GDP fall over the transition period).

When corroborated with the larger number of students, the situation looks bleaker. While the public sector spent $696 per student in 1990, this number decreased to only $307 in 1999: a 56% drop. This situation is somehow mitigated by the shift away from (expensive) technical higher education towards the (cheaper) humanities and social science studies. It remains worrisome nevertheless.

Finally, an important tool for the re-structuring of higher education was the move to formula funding, based on the number of students enrolled. This forced departments to restructure and become more attractive to potential students. The higher per capita amount provided for master programs has contributed to their development.

## Fig. 9. Social public expenditure (% GDP)

| | 89 | 90 | 91 | 92 | 93 | 94 | 95 | 96 | 97 | 98 | 99 | 00 | 01 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Romania | 14.2 | 16.6 | 17 | 16.5 | 15.2 | 15.5 | 16 | 15.7 | 15.9 | 17.3 | 18.4 | 17.2 | 18.2 |
| EU | 25.4 | 25.5 | 26.5 | 27.7 | 28.8 | 28.4 | 28.3 | 28.5 | 28 | 27.6 | 27.6 | - | - |
| Bulgaria | 20.3 | 21.2 | 24.5 | 27 | 22.8 | 21 | 18.3 | 16.3 | 17 | 19 | 21.2 | - | - |
| Hungary | 22.5 | 22.7 | 29.6 | 31.9 | 31.3 | 32.3 | - | - | 23.8 | 24.4 | 23.5 | - | - |
| Czech Republic | 21.5 | 23 | 24.2 | 22.9 | 25.9 | 25.5 | 23.3 | 23.1 | 25 | 24.8 | - | - | - |

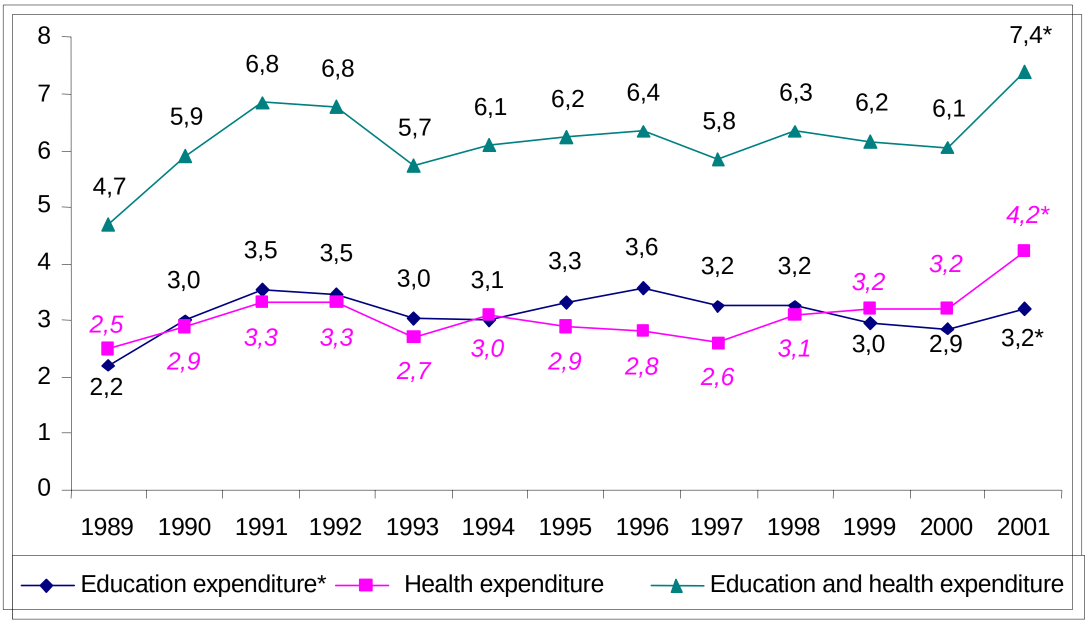
*Source: HDR Romania (2000); Abramovici, G.; Social Protection in Europe. Statistics in focus; EUROSTAT, (nr. 1/2002); Ministry of Public Finances*

## Fig. 10. Total public expenditure (% GDP)

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| Romania | 33.9 | 35.6 | 37.1 | 35.5 | 35.2 |
| Czech Republic | 42.6 | 41.5 | 43.9 | 45.8 | - |
| Poland | 45.6 | 43.8 | 43.4 | 43.8 | - |
| Hungary | 52.2 | 53.1 | 50 | 48.2 | - |

*Source: Ministry of Finance*

## Fig. 11. Public budget expenditure for fundamental social services (education and health), % GDP, 1989 - 2001




*Source: INSSE; Ministry of Public Finance*
**Education expenditure includes the expenses from the state and local government budgets*

## TEACHING STAFF

Fig. 12 illustrates the fact that the increased (in relative terms) resources have been directed mainly towards the increase in staff numbers. However, the average wage in the education sector is still the second lowest in the economy, higher only than in the health sector. In fact, the two trends are not completely unrelated: since the top priority in the education institutions was to expand them in size, it is small wonder that the funds were spread around more thinly.

Higher education has been the main beneficiary of the increase in staff numbers. It is worth mentioning though that teaching staff doubled over the period, while the student population tripled, which resulted in an overall deterioration of the student/professor ratio.

**Fig. 12. The personnel increase (1989 = 100)**

| | *Total* | Pre-schooling | Primary | Secondary | High school | Higher |
|---|---|---|---|---|---|---|
| 1996 | *+37* | +25 | +19 | +24 | +120 | +101 |
| 2000 | *+11* | -4 | +6 | -1 | +30 | +94 |

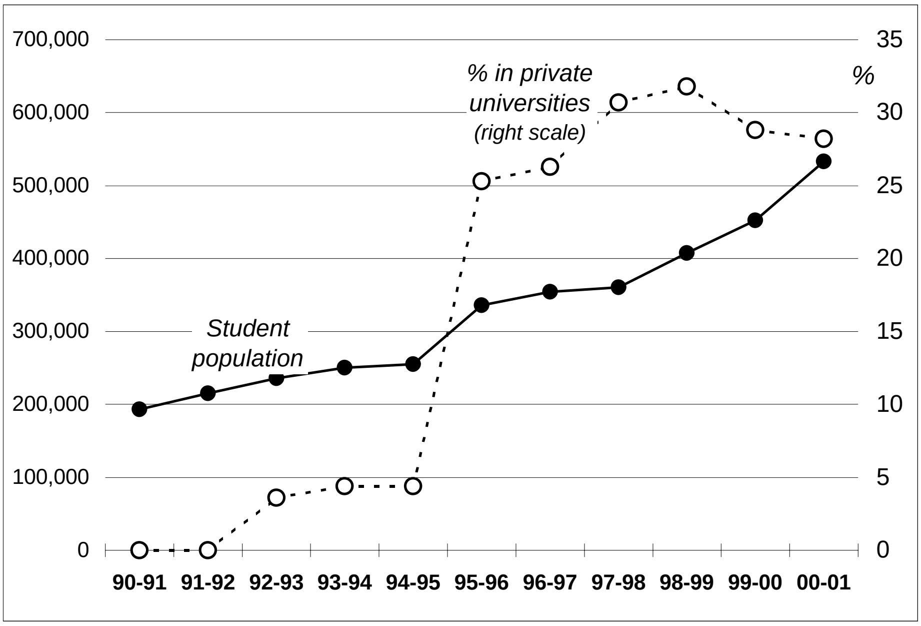
## MUSHROOMING PRIVATE UNIVERSITIES

**There is no reason to fear the 'over-expansion' of universities, public and private, as long as the cost is paid by customers**

As mentioned above, the private sector is quickly developing, being largely responsible for the increase in the student population. Public higher education is still more rigorous in student selection, while private universities have as a rule copied state universities, failing to offer a genuine alternative. Scientific research in private universities is unsubstantial or non-existent. Private universities do not have their own academic staff, except for about 5 or 10% (at the 1996 level), employing mainly the academic staff of public universities or persons who are not qualified to teach. Computing the student and staff numbers in the public and the private universities, one gets a students/professor ratio in 2001 of 15.5 in the public sector and a whooping 46 in the private sector. This spread raises further questions over the quality of private universities' teaching. Wide discrepancies exist even among the private universities themselves: some private universities are comparable to the most competent public universities, while others can barely observe the national standards. These conflicting trends in the private sector where brought under spotlight by the decision in late 2001 by the Ministry of Education to withdraw the license from a number of private universities.

The paradox of the Romanian private universities is that they have a lower status than the largely fee-free public universities (even if the quality of their education is increasing) and attract students from lower income status. This fact is explained by the 'informal' privatization – the continuous increase of private-tuition (averaging at present around $600-700 per year), a main (tax-free) source for supplementing the income of teachers. The decrease in quality of public institutionalized teaching, and the extension of this informal privatization are curtailing the ability of less prepared students to pass the competitive entrance examinations of public universities. However, other research has found that private university students spend more money on living expenses than their colleagues from public universities.

**Fig. 13. Contribution of private education to the increase in student population**




## THE ANSWER OF THE MINISTRY OF EDUCATION

The Ministry looks determined to curtail the expansion of higher education. Private universities have been the first target. In 2001, the Ministry has cancelled the accreditation of a number of private higher education establishments. In 2002 it even decided to tax the revenues of private universities and redistribute part of the money to the public ones.

**The new law is perceived as expropriating public universities' property**

Private money has found its way in public universities too. Faced with the lack of public funding, state universities have funded their expansion by introducing special places funded through tuition fees, in addition to the public funded ones. In response, the government has decided in 2002 to tax the revenues of those public universities who take in more students than the number approved by the Ministry. The row has been compounded by the apparently arbitrary fashion of allocating the tax-funded places between universities. Minister Andronescu herself, a former professor in the Chemistry Department of Bucharest University, was accused of favoring her former employer. This may not be true – but such accusations are unavoidable as long as the government does not set up a transparent mechanism for allocating publicly-funded places in universities, by subject and institution, which at least creates the impression of objectivity.

Late in 2002, the Ministry produced a draft for a higher education law. Its clumsy approach has created confusion (apparently there have been as many as eight different versions of the draft), and has raised the whole academic community up in arms. According to the law the Ministry would take control of the extra-budgetary revenues of the state universities. It also envisages to take over their assets and property, which expanded dramatically in the last 4-5 years. Finally, the tax-funded places would be eliminated, and the government would instead provide means-tested scholarships.

Another controversial measure included in the draft would restrict the autonomy of universities, by creating university boards where the representatives appointed by the government would outnumber those elected by the academic body. University rectors would be appointed by the President of Romania, upon the recommendation of the Education Minister. Moreover, the Ministry has opened itself to the charge of political bias: the draft prohibits the rector from being a member of a political party. This can be perceived as directed against two of the most influential rectors in the country: professor Marga of Babes Bolyai University in Cluj, a former Minister of Education himself and former chairman of the Christian Democrats (PNTCD); and Rector Oprea of Alexandru Ioan Cuza University of Iasi, local leader of the opposition National Liberal Party (PNL).

## CONCLUSIONS

The changes in higher education have come a long way. The higher education system has undergone a large expansion, in response to the strong demand pressure and improving the Romanian statistics in comparison with both Western and neighboring countries. This means however that quality concerns have been less addressed. A diversification of specializations and a shift of emphasis have also taken place. In spite of the apparent convergence with the Western models, however, the Romanian education system remains focused on the needs of the provider rather than of the student population and of the society in general. The subjects, the number and geographic distribution of places and the funding are tailored to the needs of the teaching and administrative staff. Many changes reflect their strive for status and perk, not the needs of the labour market.

**The state should not micro-manage public universities, but subsidize performance and enforce quality standards**

The Ministry of Education struggles to find the answer to these challenges. The resources coming from the budget are clearly not sufficient any more, and as a result the government feels that it loses control of the administrative leverages it used to employ in order to impose changes upon the universities. With neither hierarchical subordination, nor effective competition for public resources, there is no pressure on universities to change, innovate and adopt best practices. As it was mentioned before, the new private sector has not been so far an adequate alternative to the public sector either. The answer of the Ministry to this situation has been twofold:

- On one hand it has tried to stifle the expansion of both private and public universities, by restricting their ability to raise money from the student population. In an under-funded education system, this strategy does not make sense. Except for the situation of a few regulated professions (such as medicine), there is little scope for the state to get involved and curtail the free expansion of higher education – as long as this is not done at the expense of the public purse.

- On the other hand, the Ministry tries to increase administrative control over universities' decisions. In the case of public universities, and up to a point, this is understandable: "shareholders" (i.e. the society at large) should have a say in how their money is spent. But pushing it too far, and allowing it to be seen as a political takeover, is not. Ultimately, the central administration must understand that it cannot possibly micro-manage the university system, and that instead it has to rely on creating the right incentives.

The policy-making and communication strategy of the Education Ministry have been rather clumsy. It is difficult to find in media any defense or explanation of its intentions. The whole public debate has been largely dominated by the opponents of the new law. The large number of versions of the new draft have only amplified the confusion and suspicion. Whatever its intentions, the Ministry allowed itself to be perceived as a champion of centralization – or, worse, of centralization with no clear purpose – and interested in seizing the universities' property and decision power.

Things can be done differently, however; for example by enforcing quality standards. While no silver bullet, this will go a long way to curtailing unsustainable expansion of universities. However, quality in education should be measured in terms of outcomes (largely, the success or failure of graduates in real life) rather than through a traditional, bureaucratic set of inputs (such as the size of premises, number of books in library, formal qualifications of staff, etc). Subsidizing performance, instead of the existing academic establishment, will force universities to adjust the level inputs themselves.

**'Free-for-all' creates plutocratic bias: you need to be rich in order to get access to free public services**

Relying more on self-financing by students and channeling the public resources towards means-tested scholarships also has obvious advantages. The overall resources of the higher education system could grow and the restructuring of obsolete specializations speed up. In addition, the system would provide more equality of opportunity. In spite of the 'free access to education' slogan, high-school graduates from rural areas are only half as likely to end up in higher education as their peers from towns and cities. Cultural factors may play their part here, but also important is the widespread system of private, informal "supplementary" education, which is quite expensive and practically is a pre-requisite for entering the most prestigious (and free) public universities.

***

## Authors and contributors

Unless otherwise specified this report is brought to you by staff experts of the Romanian Academic Society (SAR). Contributors to this issue are:

- Bogdan Chiritoiu
- Daniel Daianu
- Cristian Ghinea
- Sorin Ionita
- Sebastian Lăzăroiu
- Alina Mungiu Pippidi
- Liviu Voinea
- Victoria Timofte (Research Assistant)

EWR Public Opinion Surveys are designed and analyzed by Alina Mungiu Pippidi, and executed by the Center for Urban Sociology (CURS).

This report, as well as past issues can be downloaded from UNDP Romania's website,

**http://www.undp.ro/**

This report and other SAR publications are available (also in Romanian) at SAR's Internet website

**http://www.sar.org.ro/**

You can also request them in electronic or hardcopy format from

**office@sar.org.ro**

**Romanian Academic Society (SAR)**
**15 Petofi Sandor**
**Bucharest 1, Romania**
**++4021-2221868**