

SPECIAL ISSUE

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IS 2007 FEASIBLE?

THE STATE OF ROMANIA'S EU ACCESSION

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CONTENTS

Selected Indicators.....	1
Foreword.....	3
I. GOVERNMENT	
1. Corruption and Political Process.....	5
2. On Justice.....	9
3. Public Administration Reform.....	12
II. ECONOMY	
The Elusive “Functional Market Economy”.....	20
III. SOCIAL	
Migration: Fears are Exaggerated.....	33
IV. CONCLUSIONS AND RECOMMENDATIONS...40	

Macroeconomic indicators; Selected EU candidate countries

	CEH		HU		POL		SK		BUL		RO	
	I	II	I	II	I	II	I	II	I	II	I	II
GDP, % annual real growth	1.0	2.2 tr1	4.4	3.6•	6.9	1.3 2002	2.2	4.4 2002	4.8	5.0•	4.8•	4.3 (Q1 - 03)
Inflation rate, % Dec/Dec	10.0	1.8 2002	18.3	5.3•	13.2	0.8•	8.4	3.4 2002	3.8	-0.2 (Q1)	14•	7.3 (Aug 03)
Budget Deficit, % GDP	-6.1	-7.25•	-2.2	-6•	-3.2	-5•	-3.7	-4.5 2002	-4.4	0.3 (Q1 03)	-4.4	-2.7•
Unemployment rate, %	5.2	8.9 2002	8.1	6.0•	10.3	18.1 2002	17.9	17.8 2002	17.4	15 (Q 2 .03)	6.6 Aug 2003	6.6 (Aug 03)
Gross foreign debt, % GDP	41		63.1		28		37.3		71.9		33.0 (2002)	
Official gross foreign reserves, in months of imports	4.9	6.1 (Q1 03)	5	3.8•	5.9	8.3 2002	3.7	5.9 2002	5.3	5.2•	4.7•	4.7 (Sep 03)
Agriculture efficiency: GDP share/ employment share				0.97		0.28				0.48		0.36
Private sector, % PIB			65	80 (2001)	60	65 (2001)			71			67 (2001)

Source: European Commission, IMF, national statistics;

Legend:

I Macroeconomic indicators at the time the selected candidate countries were declared "functioning market economies"

II Latest macroeconomic indicators (2002/2003)

• IMF projections

Foreword

Never before have the Romanian government and public waited so excitedly the publishing of the regular European Commission country report. The suspense is justified by the fact that Romania is the last among candidates not to have yet received the status of 'functional market economy'. There is now less than a year to go until the presumed end of negotiations, in the fall of 2004. Romania still has 11 *acquis* chapters open, and many of the 19 provisionally closed were concluded without a sustainable policy of implementation being adopted or even discussed. If Romania fails to end negotiations by end 2004, the EU's calendar makes it highly implausible that she will meet the 2007 target. As we approach the end of 2003 the time has come to ask if these dates are realistic. This year was no better and no worse than any other. If things get more heated, it is because Romania's usual pace of reforms is no longer good enough when she carries the legacy of past delays and the deadline nears every day. What are the chances that the delay is recuperated in the next year, and that an increased speed in negotiations is matched by an equal commitment to implement the *acquis*? The task is not impossible: Slovakia in its last year of negotiations had a comparable delay, and it met the target. But Romania has always lagged behind Slovakia in political will.

The Romanian economy has grown well in the last years and the trend is still positive. In the same time the perception of corruption in the economy as captured by the index of Transparency International has not decreased, despite packs of legislation against corruption passed in the last two years. It is in this contradiction that the main dilemma of the Romanian economy can be found. A great part of the economy definitely operates as a market economy and would deserve an upgrade. But it is equally clear that parts of the economy have ended up in the property of predatory elites, which managed to hijack privatization to their profit.

This also happened in the countries accepted by the European Union this year. How substantial is the share of the economy which depends on state capture in order to survive and which would not be competitive once Romania would join, as it could no longer enjoy eternal rescheduling of bad debts, preferential contracts and credits? In our view this is the essential question on which the appreciation of Romania as a market economy should rest upon. Romanian newspapers are full of names of these privileged entrepreneurs. But how much of the economy is infested with this gray network syndrome? Clearly the phenomenon cannot be so widespread, or the macroeconomic Figs would not look so good as they actually do. In the same time some indirect indicators, such as the level of arrears, remain a source of concern. What is clear is that the answer to the question cannot be given on purely economic grounds. The main source of corruption in Romania is politics.

The first part of this report would therefore review the progress made in the crucial field of governance, such as reform of public administration, political process, judiciary and corruption fighting. In the second, economic section the arguments are then reviewed in favor and against an upgrade of the Romanian economy. Romania is discussed in this report by comparison either with Central European countries which have already managed to join, or with Bulgaria, its partner in the 2007 accession target, which in 2002 was declared a functioning market economy. Finally, recommendations are made to improve the prospects of Romania's EU accession.

I. GOVERNMENT

SLUGGISH PROGRESS ON GOVERNANCE REFORM

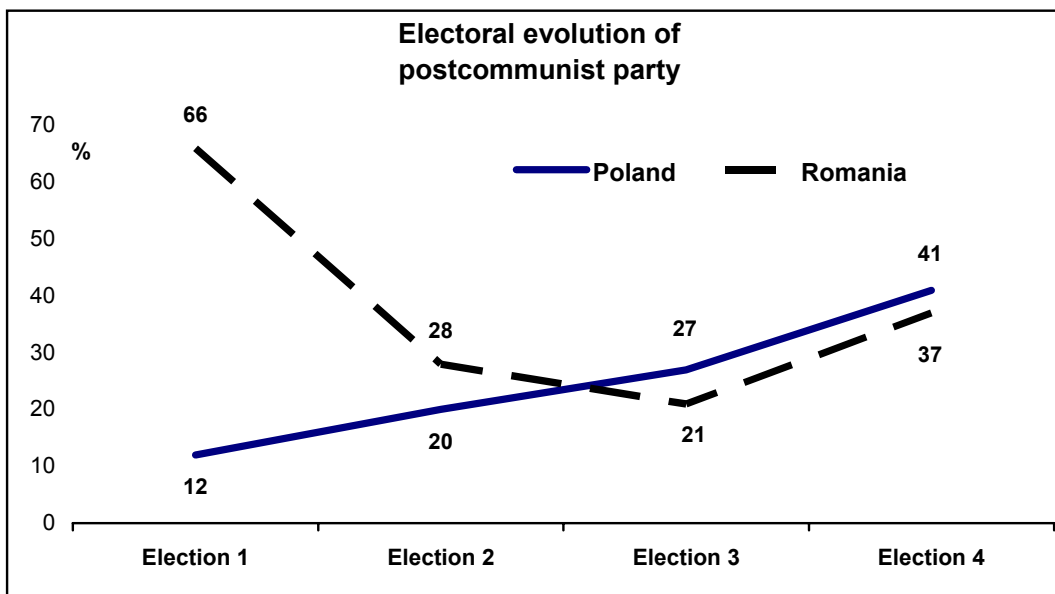
1. Corruption and Political Process

The Romanian political system has always been less competitive compared to the other accession countries. Romania had the most belated political swing in the region as late as 1996, and she is the only country in the accession process to have had three postcommunist governments out of four full cabinet terms after 1989. The Fig tells more about the competitiveness of the political system – the difference in skills and resources between postcommunists and anticommunists – rather than about voters. If one compares Romania to first wave accession Poland, for instance, the best comparison match (large population, high number of peasants) one is stricken by the resemblance of the electoral patterns in the two countries. The difference was considerable in early '90s, due to exceptional circumstances (Romanian postcommunist party ran in 1990 not as successor of Communist Party) but it has narrowed down since considerably. If Poland does better than Romania, the blame can be laid on four reasons:

- For the health of economic reforms it seems now that it was better to start the transition with an anticommunist government; at the times Poland was engaged in shock therapy and attracted investors Romania was still struggling with democratization issues, such as miners' riots, usefulness of property restitution, and so forth.
- For the sake of accountability it appears better to have regular rotations in power once in four years. The Polish anticommunist coalitions were as squabbling and divisive as the Romanian ones, but the swing nevertheless acted well to prevent any political actor to gain a major advantage and capture the state.
- Polish former Communist party was a lot more market-friendly and certainly acted better on property issues than Romanian postcommunist party (FSN, then FDSN, then PSDR, then PSD). The Polish party reformed early and eased fears from the first time when it returned to government by acting decisively as a market friendly organization.
- Romania is the only accession country where the an anti-system party (Greater Romania Party, PRM) has reached such good electoral scores (Fig. 1)

The Romanian political system is the least competitive in the region

Fig. 1. Comparing political competitiveness of Romania and Poland



Electoral competition between incumbent and challenger elites

	%	ELECTION 1	ELECTION 2	ELECTION 3	ELECTION 4
Poland postcommunist party		12	20	27	41
Poland anticommunist party				34	5.6
Romania main postcommunist party	(66)		28	21	37
Romania anticommunist party			20	30	5
Romania anti-system party (PRM)			3.9	4.5	19.5

Under these circumstances, the creation in September 2003 of an alliance of the two main opposition parties, the Democrats (PD, led by Traian Băsescu) and the Liberals (PNL, led by Teodor Stolojan) is positive news. Together, the alliance can defeat PRM, the radical populist party of Corneliu Vadim Tudor, in local elections. Although the current decision of the two parties is to run separately in local elections and on joint lists in general elections only, their alliance is still too recent and was achieved in spite of too much internal opposition to consider such early hints as definitive commitments. Considerable capacity building is also still needed for the alliance to be able to win elections and govern well, but the first step was taken. A rotation in power in 2004 would not jeopardize European accession, but may prove the only way to unseat the gray economy networks (more about this in the *Economy* section). The political system is now more balanced due to the existence of a stronger opposition. Even the government party will benefit from a stronger opposition, shaking it from the current state of complacency. Its domination in the last two years seems to have been counter-productive for its declared goal of internal reform and creation of a modern social-democratic party. As the comparison with Poland shows, what Romania lacks is high-quality political elites, both in the postcommunist and the anticommunist camps, because; otherwise, constituencies the public for both is in both countries are quite similar.

Comparative surveys confirm that the Romanian voters are no less democratically oriented and its citizens as critical towards the state as their

Central European counterparts. Overall political trust is extremely low, but not below the regional average. Courts and Parliaments enjoy little or no trust, but if one compares again Romania with Poland one finds no significant difference (Fig. 2-3). Clearly the difference in performance rests with the elites, not the public.

Fig. 2. Political trust in institutions (%) in accession countries

	Parliament	Parties	Courts	Police
Bulgaria	26	25	24	31
Czech Republic	20	21	34	40
Poland	20	8	15	21
Hungary	16	14	36	29
Romania	13	9	19	36
Slovenia	10	8	26	24
Estonia	10	8	26	30
Lithuania	9	8	16	19
Latvia	8	7	24	27
Slovakia	8	9	15	26
<i>(New Europe average)</i>	<i>(14)</i>	<i>(12)</i>	<i>(25)</i>	<i>(28)</i>

Source: New Europe Barometer (2001)

Fig. 3. Preferences for undemocratic alternatives

	Communist	Military	Dictator
	(% regarding as better)		
Slovakia	30	3	25
Bulgaria	27	132	28
Slovenia	23	6	27
Poland	23	6	33
Czech Republic	18	1	13
Romania	19	14	32
Hungary	17	2	17
Lithuania	14	5	40
Estonia	8	2	40
Latvia	7	4	38
<i>(New Europe average)</i>	<i>(18)</i>	<i>(6)</i>	<i>(29)</i>

Source: New Europe Barometer (2001)

Public opinion does not differ much from country to country. But the quality of political elites and the accountability mechanisms are clearly lower in Romania than they should be. Political migration reached a scale that is no longer comparable with Central European countries, not to mention established democracies. Even the spokesperson of the government party in Romania belonged to a different party barely a year ago. In the same situation are many ministers, Romania's main representative in the European Convention, and so forth. Parties grow when in government and shrink after losing office by orders of magnitude. As MPs are elected on party lists, and therefore the constituency votes for the party rather than the person (the Fig of voters who cannot name their local representatives is very high), this practice is twice infamous. First, because every politician

The problem is the poor performance of elites, not the general public

becomes a potential client, which and that corrupts politics completely; second, because they violate the result of elections, depriving vertical accountability of any meaning. The situation is no better in the case of mayors, although they are directly elected, as they switch party frequently, usually in favor of the government party or its satellites (Fig. 4). The usual claim is that such a move provides better access to government grants. In fact the theory that constituencies fare better after their mayor switches party is yet to be tested.

Fig. 4. Political migration

Parties	Mayors since last elections		MPs since last elections	
	2000	2002	2000	2002
PSD (govt)	1050	1584	210	227
APR	284	79	--	--
PRM	66	53	121	108
PNL	251	262	43	40
PD	483	407	44	37
CDR	147	116	--	1
PUR	32	64	10	7
Independents	159	90	--	11

Once corruption starts from the top, it is difficult to argue that fighting petty bureaucratic corruption is a worthy cause – or even a feasible one in an environment of growing cynicism. Romanians are highly skeptical that the new agencies created to fight corruption are impartial and do not protect people in power.¹ Other qualitative aspects also reduce the effectiveness of political process and the governing performance, thus pushing Romania's democracy scores below that of other accession countries. Comparing again with Poland, Romania is rated by Freedom House on the average three times worse on the main items of quality of democracy, political process, media, governance, corruption and justice.

Fig. 5. The quality of democracy in Romania and Poland

Year		Political	Media	Governance	Corruption	Justice
1997	POL	1.50	1.50	1.75	--	1.50
	ROM	3.25	4.25	4.25	--	4.25
1998	POL	1.25	1.50	1.75	--	1.50
	ROM	3.25	4.00	4.00	--	4.25
1999-2000	POL	1.25	1.50	1.75	2.25	1.50
	ROM	3.25	3.50	3.50	4.25	4.25
2001	POL	1.25	1.50	1.75	2.25	1.50
	ROM	3.25	3.50	3.75	4.50	4.25

¹ SAR-CURS survey, August 2003.

Businesspeople and experts seem to agree in their assessments on corruption, and here Bulgaria scored above Romania in the last years². This year Romania passed a stuffy anti-corruption package, but due to constant scandals in the media about top corruption cases, and the spectacular ineffectiveness of law enforcement agencies to nail at least once a political entrepreneur close to the government, the perception did not improve. How can it, when the largest advertising campaign of the year, the campaign for the referendum on the Constitution, was commissioned without any tender to an agency favored by the government? And if Public perception will not improve in the future just as a result of passing legislation. People want facts, not additional interpretable and wordy laws.

The revision of the Constitution is a missed opportunity for a reform of the political system. After years of debate, all the proposals with a real potential to change something did not pass through. The final result is that the Constitution will bring no improvement in the separation of powers, no increase in the effectiveness of the two chambers, no raise in the quality of MPs. A deadline of 45 days was introduced to avoid delays between the two Chambers, but as no part of the chain was eliminated this risks only the impeding further the already low quality of legislation passed. Even the much praised change of wording at articles regarding protection of property and the rights for the Hungarian minority are redundant at the best, if not hypocritical. The Constitution did not prevent a better treatment of property, nor did it forbid the use of minority languages in Courts with a translator, and if these practices were not encouraged it was because of lack of political will, not the Constitution.

The new Constitution: a step forward, but also a missed opportunity

2. On Justice

The situation of property restitution remains the best example. While putting in the new Constitution that property would not be nationalized in the future – an unlikely possibility in view of Romania's EU accession – Romania fights daily (and loses) in the European Court in Strasbourg not to return nationalized property. All the extraordinary appeals against owners are still pending: the newly-appointed General Prosecutor made no sign to he intends to backtrack on this issue. While the Constitution was voted and this report went to print, the Supreme Court of Justice ruled in an extra-ordinary appeal that not even a building confiscated by the Red Army without any papers and then passed in the property of the Romanian state – still without papers – can be returned to the former owners.

The gap between what the government says and what it does is nowhere more obvious than in the field of judicial reform. Here 2003 was *the* crucial year, when all the four laws making the new framework of the organization of judiciary should have been enacted, as well as the criminal code, procedure of criminal codes and a new fiscal code. As Fig. 6 shows, though some progress was made, the results are below expectations, and thus the

² See Transparency *International Index of Corruption 2001, 2002*; also Freedom House Nations in Transit scores

conclusion of the Home and Justice Affairs acquis chapter was postponed. No decision was taken on the two most important issues, which can bear an influence on the crucial topic of political intervention – at least none known to the wider public. After the Constitution is amended the Supreme Court of Justice will be replaced by a 'Court of Cassation'. The current judges will serve until their limited tenure ends. By what mechanism will be used to appoint the new judges?

**Judicial reform
– a large gap
between
words and
deeds**

Normally, the Supreme Council of Magistrates (SCM) should nominate them, as the elected body empowered by the new constitution to ensure the independence of judiciary and manage the career of magistrates. But how would the Council be appointed to insulate it from political intervention? The mechanism introduced last year through an emergency ordinance was not good and unsurprisingly failed to make this new body autonomous. The composition one proposed by the new Constitution is not so different, making the President (representative of the executive branch) chair the Council. The Council also keeps prosecutors in, who are directly subordinated to the Ministry of Justice, and care was taken that the President of the Supreme Court remain fairly weak so it cannot compete in any way with the Minister of Justice. Even the election of member judges members of SCM is entrusted only to superior Courts, conditioned by seniority and a PhD, so diminishing further the chances of post-1989 judges of being elected. On top of all these, there is a final screening by the Parliament, where by tradition there is little bargaining but rather majority imposition. Also the Parliament, therefore the majority, gets to appoint two members of civil society, lowering further the number of direct representatives of judges. It is now clear that even if a formal transfer of power is made from the Ministry of Justice to the Supreme Council, it will make little difference in practice. The will to democratize the judiciary and allow the large whole professional body to have a say in the election of SCM is so far missing.

The resistance in the field of judiciary reform is quite formidable. It should not be blamed on the Ministry of Justice only. Lawyers who dominate the judicial committees of both chambers had practiced many years under the Communist regime, when admission to Law Schools presupposed the screening of family files. What can be more conservative than this group of aged persons ruling over their profession, socialized in Communist times? The situation of high Courts, also because of age barriers at the entrance, is only slightly better. Drawing on this restricted community in order to start a revolution is a nearly impossible task. There is no critical mass in favor of change, and grassroots challenges by judges from ordinary Courts, unhappy with their social standing and low pay, have been repressed so far.

Fig.6. State of the art in state reform, end 2003

POSITIVE EVOLUTIONS	NEGATIVE	REDUNDANT OR AMBIGUOUS
Politics more competitive by unification of opposition parties	Political migration on the rise Main political opponent (Mayor of Bucharest) investigated again in a case investigated and closed eight years ago	Constitutional revision of no practical consequence for domestic political practice Article in revised Constitution rules out future referendum for approving accession
New criminal Procedure Code passed	Extra-ordinary appeals maintained in penal procedure and still abused in practice	National Anti-Corruption Office created last year carried on its activity
National Authority for Control reuniting all government control agencies after govt restructuring seems to increase the control capacity of govt Three ministers involved in corruption and plagiarism scandals resigned	Resignations of the three ministers came after months of public scandals	Conflict of interest when disbursing public funds, as well as European funds, remains mostly unregulated.
Most drafts to complete reform of justice now ready after revision of the 2000 'Stoica' package	None of them passed yet, two crucial drafts on Public Prosecutor and the nomination mechanisms of Supreme Council of Magistrates (CSMSCM) not public yet and Supreme Court still not public Last year reorganization of CSM SCM failed to remove judiciary from political control ('Florea' scandal)	New magistrates statute draft keeps strong Ministry of Justice, but as CSM SCM in the current form is also subject to political influence, this does not change much
General Attorney Joita Tanase, champion of extra-ordinary appeals, resigned	Appeals still go on in property trials under his successor	
Good decentralization framework inherited was not changed	Weak enforcement of existing laws, discretionary resource allocation undermine local governments capacity; Soft budget constraints allow rent-seeking and preferential arrangements	Some additional reassignments of functions and revenues to local governments, mostly as mandates
New laws adopted on: anti-corruption, civil service, and the transparency of decision-making	The law against conflict of interests not enforced in punctual cases; Declarations of assets not taken seriously by MPs; No instrument was produced to assess and manage the civil service, which remains fragmented and opaque	INA was strengthened; efforts were made to recruit 500 young professionals in the public administration; an exercise was launched to produce a government PAR strategy
The government promised emergency ordinances will be used less (also some limitations in the constitutional amendments, if approved in referendum)	Top government leadership unwilling to spend political capital on real reforms of the civil service and policy making process. Inflation of poorly-conceived laws is likely to continue.	

3. Public Administration Reform

Romania scores last among EU accession countries on the World Bank composite index of governance quality – an average of six scores measuring accountability, government effectiveness, regulatory quality, rule of law, control of corruption, and political stability – falling behind a non-accession country like Croatia (see Fig 7). But more important, Romania witnessed the smallest improvement in performance between 1998 and 2002 from all the states included in this group. This is concerning, especially since part of the rise is explained by one of the six indices (political stability). The findings confirm that the low grades Romania got in the past from the EU Commission in the annual country reports on public administration reform are not entirely subjective or politically motivated.

Good governance leads to economic growth – but the reverse is not necessarily true

There is ample evidence today that sustainable growth is heavily dependent on the quality of governance in a particular country. One of the most recent and complete such evaluations, conducted on 175 states, aggregating the main cross-country measurements produced by various organizations, reports a strong and positive causal link between the quality of policies and administration on the one hand, and economic performance on the other³. But even more interesting, the authors report a weak and *negative* causation running in the opposite direction, from per capita income to governance, after the first positive effect is controlled for.

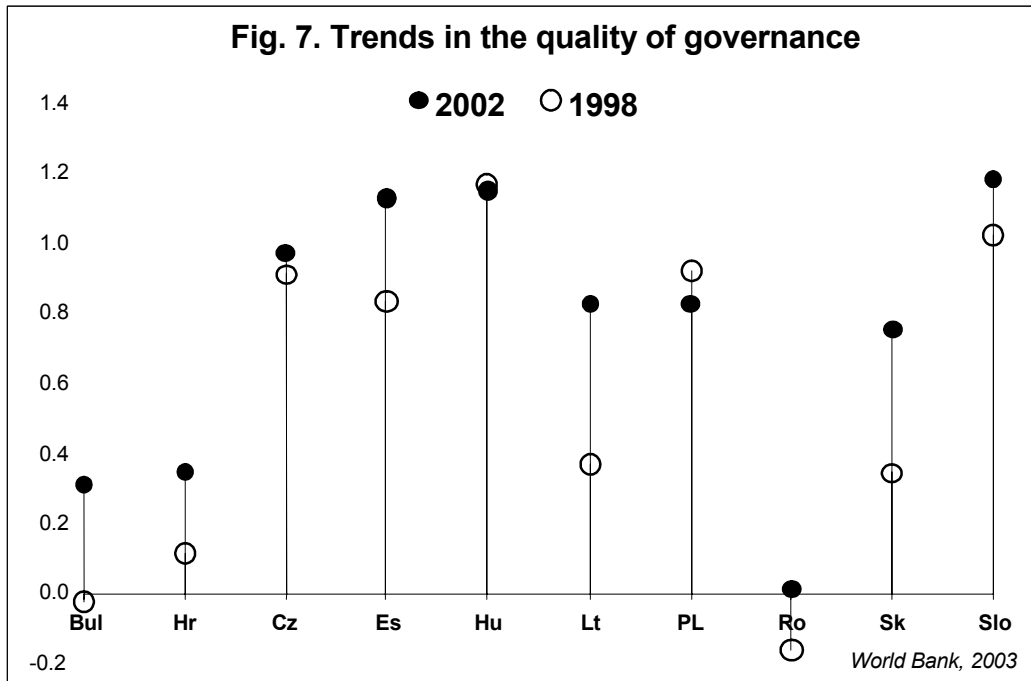
In other words:

- good governance leads to growth and prosperity;
- but economic growth and greater prosperity do not by themselves bring about good governance – on the contrary, sometimes they can encourage misgovernance.

These conclusions have significant policy implications, especially in countries like Romania. Waiting for the time to pass and solve the problems of misgovernance as the society gets richer does not work. Actually it may even aggravate them, since greater wealth only raises the stakes of the social transactions, without changing their nature, and increases the pressure of rent-seeking, state capture and bureaucratic corruption. “When the institutions of the state are captured by vested interests in this way, entrenched elites can benefit from a worsening of the status quo of governance and can resist demands for change even as incomes rise.” (*op cit*).

The first and the following sections of this report documents with data that in some transition countries – Romania included – something like this may be happening. When economic growth does not translate immediately into higher public satisfaction, support and legitimacy for the new democratic institutions, this may be a symptom that it is not associated with better government. And if all these ingredients are missing, the economic performance risks to become unsustainable in the long run.

³ D. Kaufmann and A. Kraay, 2003. *Aggregate Governance Indicators 1996-2002*, www.worldbank.org/wbi/governance



Since good governance is not a “luxury good” to which a country automatically graduates when it gets richer, it means that reforms in this particular area should be regarded as a separate goal which must be pursued with specific strategies. Although there is no specific *acquis communautaire* on public administration reform, the topic has gradually climbed at the top of the agenda of the EU-Romania relationship in the last years, a development reflected in the annual country reports. Approaching this subject is difficult, as the area of **public administration reform (PAR)** is hard to measure for monitoring purposes. However, a consensus emerged that PAR should advance on three main directions:

a. Decentralization. Real decentralization means the existence of sub-national tiers of elected government, with their own legitimacy and scope of decision-making. A good process of decentralization presupposes a clear assignment of (i) attributions, and (ii) sources of revenue, by tier of government. If decentralization is to be something more than window-dressing, the relation between central and local governments has to be defined through iron rules protecting the area of exclusive local autonomy. The shared resources have to be allocated according to transparent and non-negotiable criteria.

b. Civil service reform, including the fight against bureaucratic corruption. A professional, politically neutral and stable bureaucracy must be created which is able to carry out the daily routine of public service delivery and assist the political decision-makers with quality technical advice. Although in general this has been considered a “fuzzy” area of post-communist reforms, since progress is harder to quantify than in, say, privatization, a number of dimensions can be identified on which it is possible to build indicators which can be afterwards monitored: entry in the civil service must be open and competitive; there should be regular performance evaluations (where not everybody will end up with the highest grade) which feed into the payment and promotion systems; civil servants should

Romania reports the lowest performance in governance among candidate countries

be insulated from illegitimate political pressure; a fair institutional process should exist for disciplinary action; the average training level should rise in time; civil service positions should be attractive, which means a certain proportionality should be maintained with private-sector salaries; a good database should exist with complete data on civil service salaries, as a management instrument for the government; the total wage bill should be affordable and transparent, while the sector-specific arrangements and discretionary fractions of salaries should be reduced to a minimum.

c. Policy process reform, including issues of transparency and accountability. *Policy formulation* in a modern administration ensures that (i) the top cabinet meetings are managed in a way that allows it to focus on strategic objectives rather than being burdened with details of legal drafting; (ii) there is a system of sub-committees of the cabinet to coordinate a number of broad policy areas and screen new proposals before they reach the plenum – in typical EU countries about 90% of such arbitrage takes place at this level of sub-committee review; when this is done, (iii) important measures are first presented to the cabinet as short “policy options papers” outlining the main problems, trade-offs and solutions; draft laws are produced only afterwards, when the hard choices are explicitly made. A proper consultation with the main stakeholders should be organized during the stage of discussing policy options. *Policy implementation* assumes that subordinated institutions should be given clear mandates, freedom to manage themselves and be held accountable for results.

In brief, the core philosophic principles at the heart of PAR are the separation and delegation of powers. Essentially, it is all about the gradual and orderly withdrawal of the central political power from (a) local community affairs and (b) daily routine bureaucratic work. In the released space new institutions and accountable processes have to be inserted, many of which will be newly-created and involving other, non-political actors (c). The public sector institutions should become accountable primarily to their clients – the broader public – and only subsequently to their superiors. As a rule, all the relevant information produced in a public organization for reporting and management purposes, whether financial or non-financial, should be *ex officio* available to the public in a meaningful form.

What has been done since the previous country report?

A number of actions were taken by the Romanian government in the past year in an attempt to address the deficit of PAR and improve its scorecard in view of the 2003 country report.

- A comprehensive *Anti-Corruption Law* was adopted in April. In fact this was a *package of laws* including, among other things: the assets and interests disclosure requirements for top dignitaries and civil servants; measures to enhance the anti-corruption institutional framework; and a new *law of the civil service* to replace the old one passed in 1999. This law attempts to define better the scope and status of the civil service in Romania, and raises the threshold in the process of depoliticization by transforming a number of top appointed positions into a special class of “high civil servants” (for example, the office of prefect).

- A “*sunshine law*” came into effect which opens up the decision-making process in public institutions to public consultation and participation. The scope of the e-procurement system, set up a few years ago, was broadened. The new Constitution (if approved in the referendum) would also slightly constrain the ability of the government to pass emergency ordinances.
- There was a *government reshuffle-cum-restructuring* in June, which reduced the number of Romanian ministries from 24 to 14 (however, some of them survived as central government “agencies”). The restructuring was accompanied by a staff reduction, but clear and complete data in this respect were not offered.
- A *sub-committee of the cabinet* was set up, made up of eight ministers, for dealing specifically with public administration reform issues (IMCAR). Its members are supposed to meet roughly once a month. IMCAR has a permanent secretariat – the Central Unit for Public Administration Reform (CUPAR) – located in the new Ministry of Administration and Internal Affairs.
- A comprehensive *exercise of consultations* with the public institutions and various non-governmental actors was initiated in August, under the coordination of CUPAR. It consists of a series of workshops organized in various locations in Romania where the public organizations’ representatives are supposed to bring and discuss their sectoral strategies for reform. All the inputs will be integrated into a consolidated strategy of the Romanian government, which should be ready by December and represent the basis for further steps in PAR.
- The *National Institute for Administration (INA)* was shaped up, particularly since the new law of the civil service creates a legal obligation for every civil servant to attend at least 7 days of professional training per year. Moreover, the “young professionals” program was initiated with the objective of recruiting 500 young people educated abroad and place them on a fast-track career of “euro-councilors” in all the ministries and central government agencies.
- A number of *foreign assistance programs* were initiated, financed by EU, World Bank or bilateral donors, aimed at providing resources and technical expertise into the process of public administration reform. Most notably, there are important funds being currently pumped into central administration streamlining, professionalization of certain functions (for example, the prefect), assisting INA and the National Agency for Public Servants to understand and carry out their new duties, or increasing the capacity of local governments.

**Decentralization
– good
framework
eroded by weak
enforcement
and informal
practices**

Stumbling blocks in the public administration reform

However, it is questionable that all this legal and institutional frenzy will have a significant impact on reality. Among the three areas presented above, **decentralization** is probably the one in which most progress was made prior to 2001, though also one of the least well understood. By and large, a reasonably functional system of local governance was created through successive legislative acts (1991, 1994, 1998, 2001). All that was needed was

adjustment at the margins, for example by better clarifying the functions of local and county councils, spelling out the further steps in the reassignment of attributions and revenues in order to stabilize expectations, and refining the criteria for resource allocation passed down from ministries through counties to localities.

But first of all, what was needed was a strong determination to enforce the existing legislation. This has been utterly missing. Laws are ignored, interpreted creatively or openly broken in order to perpetuate the old pattern of patronizing and subordinating the lower tiers of government. In their turn, those local governments with the right political connections cherish this loose environment where there are no hard budgetary constraints and everything is negotiable on a case-by-case basis. Certain financial allocations are made in defiance to the State Budget Law in order to build political networks in territory (the equalization sums). Others are not only discretionary but also opaque, so it is hard for independent observers or the public to see where the money went and why (infrastructure funds). The new Civil Service Law requires that the office of prefect will become a professional "high civil servant", with all the limitations and protections of such a position. True, the provision was not meant to apply immediately, the implementation being phased over a period of a few years. However, only months after the law was adopted and following the government reorganization in June, a number of prefects were reshuffled. Some were blamed not for ineffectiveness as prefects, but as local party organization leaders. The former prefect of Bucharest, a military judge, was replaced by a straight two-star retired general. These developments raise a question mark, not over the speed or details of decentralization reforms, but on its very direction.

If this is the situation with decentralization, the other two areas of PAR look even worse. Overall, the same general impression is conveyed that laws are passed in order to check boxes in the matrices of conditionality imposed by international organizations, while they make little impact on reality. The previous **Civil Service** Law, adopted just in time for Romania to be admitted to start EU negotiations at Helsinki in 1999, was no obstacle against politically-motivated reshuffle of the public sector when a new government came to power. In some cases only the name of institutions were changed as a pretext for "reorganization". It is unlikely that the current version will have more teeth. The monitoring of compliance in such sensitive areas as civil service reform should follow not only the passing of legislation, but also carefully constructed indicators such as turnover rates after a change in leadership (overall, and by institution).

**Laws are passed
just to check
boxes, or as a
substitute for
real action**

The same problem with the transparency laws: there are no clear consequences if someone is found to have filled incomplete data in the assets- or interest-declaration forms. The case of a senator, recently exposed by the media as having been in conflict of interest, convey the impression that sanctions are negotiable and depend on the political affiliation of the perpetrator. There is a clear need here that the government follows up the passing of legislation with resolute action which sends a signal to everyone. Otherwise, non-enforced EU-compatible laws will continue to accumulate and contribute to the legislative Potemkin village erected by the authorities, in the heroic effort to build the new Romania.

Some changes are well-meant, but half-baked and as a result may have unforeseen consequences. The legal obligation that each of the 110,000 civil servants from the central and local administrations should take at least 7 days of training per year creates an annual public liability estimated to about 40 mil USD. The level exceeds by far the current supply of training on the Romanian market; government officials have admitted that INA can cover about 10% of the demand, at best. Besides these short-term trainings, INA should also offer long-term graduate programs in public administration. It has been slow to organize itself, but eventually managed in the fall of 2003 to select and dispatch the first class of students in a British university for one academic year. This is good – but the danger lays elsewhere: having adopted the French ENA as a model, the Romanian INA is unlikely to replicate anytime soon ENA's strengths (top class education, *esprit de corps*), while it is very probable to replicate its weaknesses (closeness, boys-club mentality, preference for deals based on informal personal connections, including across the public-private border). All these will only reinforce existing shortcomings in the Romanian civil service, and probably add exotic flavors to the original model due to the specific Balkan context where it is transplanted. A more open and competitive admission in the civil service, by removing the "preferential" treatment of INA graduates, would both make the environment more transparent and dissipate the impression that this is just another party cadre school.

The young professionals initiative is also one that should be scrutinized very carefully. Their performance will depend very much on the environment and the system of incentives in institutions. It is true that in general the Romanian public administration badly needs young people who can work on PCs, manage projects and speak foreign languages. However, most of them will stay only as long as they feel they can make a difference, and lose motivation when they see that they don't. It may seem hard to believe but there are currently cases in the central government of young people returned from abroad and working in top positions without being formally employed. They stay many months in a row on these unpaid internships and work hard in the hope that their engagement will eventually be formalized. The situation is unusual, but illustrates the point that some individuals come with motivations that are more purposive than financial, and that there is a supply of qualified labor at least for some sections of the civil service. If the turnover remains high, this shows that there are other reasons than the low pay which drive good people away.

In general, the management of the civil service remains amateurish, fragmented and discretionary. Obscurity is used by employees as a cover for incompetence – or worse. There is little institutional memory in organizations. By default they remain secretive, and the public information is hidden from the public as the only comparative advantage of otherwise unemployable civil servants. The National Agency of Civil Servants is too weak politically to perform effective horizontal screening during the recruitment process. As their representatives admit, they cannot impose anything on strong ministries, which continue to be run as independent feuds – sometimes they cannot even collect the information they are mandated to collect, such as those referring to salaries. The newly introduced annual evaluation does not rank the employees according to their actual performance since everybody gets the highest grades. As a

Low payment demotivates – but this is not the only reason why good people leave civil service

result the bonus payment system is regarded as a discretionary supplement to a wage which is anyway too low to be an incentive for performance.

In fact, there is no unitary civil service in Romanian yet – all we have is a collection of sectoral and opaque bureaucracies, run by a mismatch of sector-specific arrangements around which powerful vested interests have solidified in time. This establishment is not only unmanageable, but even hard to understand, and the government has shown little appetite for tackling the core of the problem so far. The effort to develop a database and a system of indicators to assess the current situation has been going on for some years, with donors' help. However, the Agency is sometimes reluctant to even develop measurements of output and outcome, partly because nobody has done this before, partly out of fear to step on somebody's toes.

Which leads to the natural conclusion that substantial civil service reform, and PAR in general, can only be done if there is a firm commitment at the top. The cabinet leadership should be willing to spend some political capital on painful decisions – which include staff reductions, but not only. Delegating unpleasant tasks to junior ministers is not going to work, as they cannot reform the departments run by their powerful senior colleagues. Until now this level of determination at the top has missed, and we have to see if it will be present from now on.

The **process of decision-making** remains protracted, being ambushed in various points with draft laws which flow continuously from ministries and agencies, sometimes hitting each other with competing versions of the same draft. Instead of being short, focused and reaching clear decisions, Romanian cabinet meetings are long and have unpredictable agendas. A lot of time is spent on irrelevant details, while crucial choices either pass unnoticed or are avoided on purpose. When this happens, the hard decisions are postponed indefinitely, and therefore taken implicitly by the bureaucracy in the process of implementation. This is why many times the administrative norms that follow a law are more important than the law itself – actually, they *make law*.

Public administration reform cannot be delegated to junior ministers; it requires the visible engagement of the top leadership

There is currently little chance to slow down the flow of ill-considered legislation rushed through because “reforms are urgent”, which quickly prove inapplicable and are followed by new and even more urgent bills to amend the first. In other instances the drafting and passing of laws has become a substitute for real action in Romania, a way to avoid confronting the reality. Donors have come to realize that this is a problem and sometimes explicitly ask the Romanian authorities to allow more time for debates and discuss the key issue openly, in order to increase the quality of acts and regulations. However, this is difficult, since there is no clear counterpart on the domestic side in charge with this issue. No focus for coordinating policies has emerged so far, and the civil service has no experience in costing out laws, evaluating their broader social impact and assisting the decision-makers with such expertise. Like in CS reform, there is little chance that such a policy-coordination system will appear as long as the top political leadership does not realize the importance of the problem and is willing to spend some political capital on fixing it.

The consultations organized by public authorities – whether they are required by the new sunshine law or part of broader strategies, such as the

one led by the Ministry of Administration and Interior on public administration reform – are likely to be in the end just formal exercises carried out in order to show some action or please the international donors. There is usually no conceptual preparation of these initiatives, no structure and no channel to feed the outputs, whatever they are, into the real decision-making process.

II. ECONOMY

THE ELUSIVE ‘FUNCTIONAL MARKET ECONOMY’

1. Economic criteria for joining the EU

Aspirant countries to EU accession are asked by the EU Commission in Brussels to comply with two fundamental requirements: to have a so-called “functioning market economy”; and to withstand competitive pressures inside the economic/monetary union. The first requirement – “the existence of a functioning market economy”⁴ – connotes an institutional setup (the functioning of basic market institutions) which ensures effective financial discipline, easy market entry and exit, proper contract enforcement and protection of property rights, and an adequate policy mix framework, with mechanisms to deal with adverse shocks which are reasonably effective.

The second requirement refers to the reduction in scope for the national economic policy in a region with a common monetary policy. EU accession means joining a club where, among other things, intra-trade barriers will no longer exist, there is a single currency in 12 member countries, and, in a softer form, the Exchange Rate Mechanism (ERM2) constrains exchange rate policy in the other states significantly. Both requirements are seen as essential for enhancing nominal and real convergence, without which the Union would be undermined from within.

2. Why is it important for Romania to get the status of functioning market economy?

The transition countries to be admitted in 2004 were granted the status of “functioning market economy” a few years ago; Bulgaria received it in 2002. This upgrade of our southern neighbor’s, and the debate on Turkey and other would-be accession countries, have raised the stakes for Romania in a race which becomes ever more challenging in view of the economic and geopolitical circumstances which accompany enlargement. Being left behind in a race which has its own symbols (specific criteria, diplomatic language and cryptic qualifiers, not always transparent to outsiders – such as that of functionality in the “functioning

⁴ A “functioning market economy” is quite curious terminologically; this notion cannot be found in economic textbooks, since all market economies are functioning, whether well or poorly. What the experts in Brussels have, most likely, in mind is a “well functioning market economy”, which relies on a sound institutional setup and low information and transaction costs.

market economy") can harm one country's credentials. As a result, it is easy to understand that in Romania this issue has a lot of political capital attached to it. On the other hand, rushing to join the Union at any cost can be self-defeating. The laws of economics cannot be bent beyond certain limits without threatening the very ultimate goal (accession).

Nevertheless, if the next wave of enlargement does not proceed smoothly, Romania would have to show increasingly better results in order to justify her quest to join the EU, as the inner political and economic dynamics in the Union make another round of enlargement unlikely any time soon.

3. Where does Romania stand?

Do basic market institutions exist and do free prices play their role in allocating resources in Romania? By and large, they do. In a broad sense, Romania already has a "functioning market economy" and her performance has improved substantially in recent years. Significant problems remain to be tackled such as the poor financial discipline, weak enforcement of market regulations, low transparency and stability of the regulatory framework, the inefficient public administration and judiciary. Nonetheless, some progress has been made on all these dimensions in recent years. Moreover, since some leading EU economies have a hard time in meeting the Maastricht criteria, the question could be raised if it is sensible to be over-strict with accession countries.

Romania has inherited huge structural problems, and as a result faces a number of dilemmas and constraints in reforming its economy. They appear as a series of trade-offs:

- low budget deficits which should help disinflation while there is need for public financing of badly needed large infrastructure projects;
- manageable current account deficits and further disinflation (plus exchange rate appreciation), against the backdrop of minimal trade protection, which could overwhelmingly put the burden of adjustment, primarily, on budget policy;
- productivity growth and subdued short-term welfare gains (wages grow slower than productivity in order to retain the labour costs-driven competitive advantage) while prices grow anyway (because they were initially below world levels).
- free movement of capital flows and interest rates cuts, which may strain the balance of payments while capital account liberalisation proceeds further;
- the current type of competitiveness (based on wage differential) vs. the innovation-driven type of economies, to which Romania is trying to converge (Romania's spending on research and development is seven times lower than the Lisbon target of 3% of GDP).

Romania already has a market economy, though burdened with many inherited distortions

It should be stressed, nonetheless, that some of these policy dilemmas and resulted trade-offs do not concern Romania only; other candidate countries, which are to join the Union in 2004, need also make painful decisions.

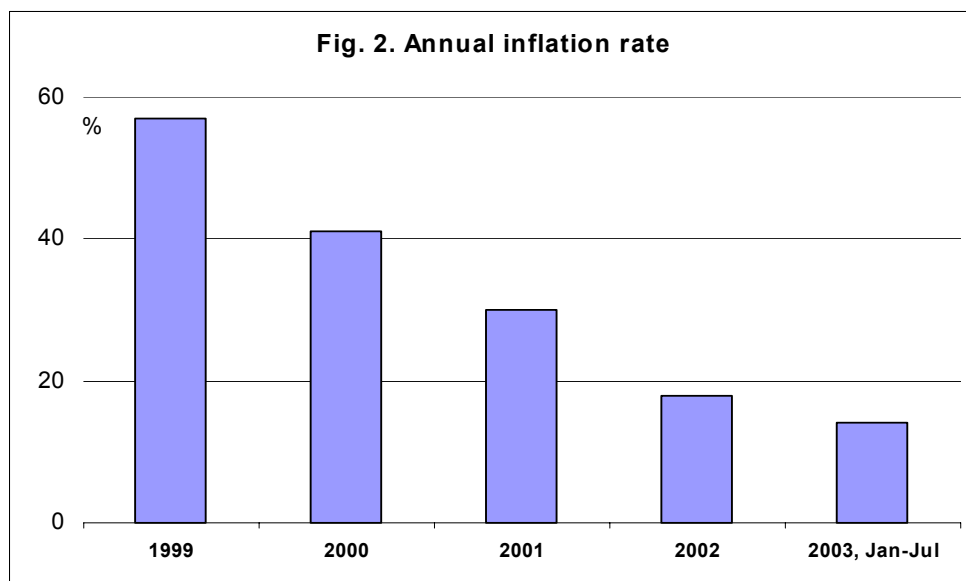
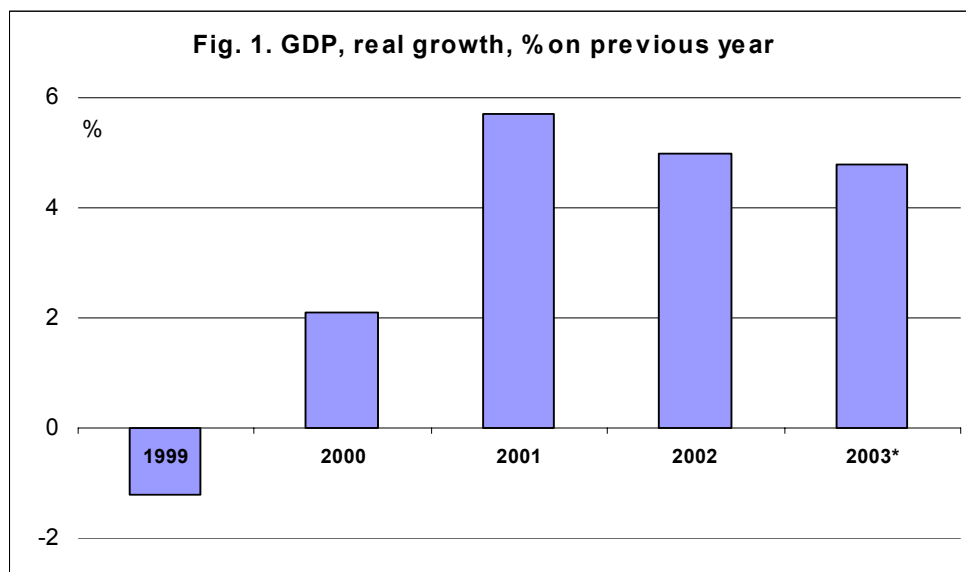
3.1. What speaks in favor of an upgrade?

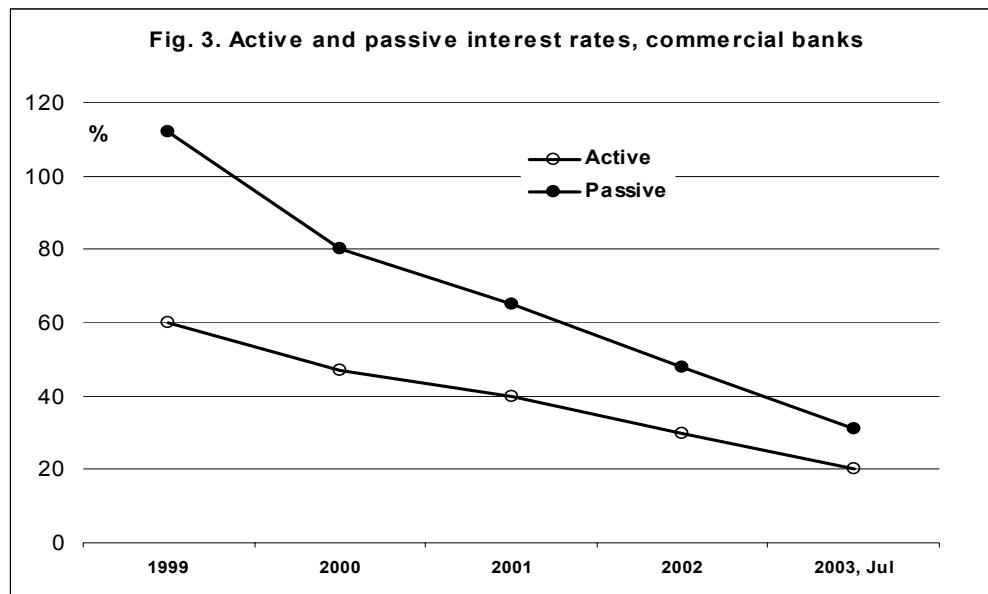
There are economic arguments which support an upgrade if Brussels' implicit criteria are to be consistently applied.

- **Economic recovery has been under way for several years now**; the GDP grew by 5.7% and 4.9% in 2001 and 2002, respectively. It would, probably, rise by around 4.5% this year; the current deceleration would be, due, primarily, to fallout from economic stagnation in the West and a bad domestic harvest. For 2004 a forecast of 5% is reasonable in view of an expected revival in EU economies, the growth of domestic non-governmental credit, a further rise in domestic investment, and, hopefully, a better harvest.
- **Inflation, the big scourge of the past decade, has been coming down consistently**: from 30.3% (Dec. on Dec.), in 2001, it went down to 17.8% in 2002, and would, likely, drop to around 14% this year; it is forecast to go further down to about 9% in 2004.
- **The overall public indebtedness has stayed below 30% of GDP**, out of which the external public and publicly guaranteed debt is cca $\frac{3}{4}$, while short term indebtedness is pretty low (below 5% of total foreign debt).
- **Budget deficits have been kept under 3%** in recent years. Albeit significant quasi-fiscal deficits blur this assessment, it is encouraging that they have shown a tendency of decline lately. **Current account deficits have been kept, on average, around 5%** in recent years while the international reserves of the Central Bank have surged to almost 7 billion euro in September 2003 (which covers more than 4.7 months of imports).
- **The private sector's contribution to GDP formation is nearing 70%** currently, while this sector accounts for over 55% of social capital in the economy and more than 70% of employed population.
- **The banking system is much sounder** nowadays, after a massive clean up operation in the late '90s and the introduction of a new regulatory framework that fits the BIS new recommendations. This evolution has taken place on the background of increasing foreign ownership in the banking sector (to above 60% of total assets and loans), which has ameliorated corporate governance in this sector. Recently, Banca Comerciala Romana, which is the largest commercial bank, has got IFC and EBRD as new share-holders. Banks are on the average better at providing effective intermediation between savers and investors. Both the active and the passive interest rates have decreased substantially, and the spread between them also diminished (Fig. 4). Likewise, the range of financial products has increased remarkably and led to a boost of non-governmental credit.
- Some **structural reforms** (including privatisation) and a more effective budget (tax) policy administration have been implemented recently. A good part of the privatization commitments undertaken in the PSAL I and PSAL II programs with the World Bank are reasonably on track: companies with a history of loss making, such as Tepro Iasi, Tractorul and Roman Brasov, and ARO have just been sold.
- **A new fiscal code** is to be adopted by the Government until the end of this year, and a special unit for large taxpayers has been established in

Bucharest in a move to strengthen tax administration. New legal framework has been created to unify the collection, audit and enforcement of the social security funds under the supervision of the Ministry of Public Finance.

- **Market access procedures** have been simplified. Registration and authorization have been simplified by setting up a one-stop-office, and a silent approval procedure was introduced. In order to facilitate market exit, a legislative project on bankruptcy and reorganisation procedures has been initiated, aiming at increasing the ability for creditors to file for bankruptcy.
- **State aid and competition.** Romania is currently applying the EC criteria in the authorization of new state aids, and is monitoring the existing aid with the goal of bringing it in line with the *acquis*. However, the issue of arrears, discussed in the following sections, questions the progress in this direction.





- **The annual yield for T-bills**, which was a major attraction for banks' investment policy, decreased from 76% in 1999 and 35.7% in 2001 to 17.3% in 2002 and 15.5% as of August 2003. This evolution has provided another stimulus to domestic non-governmental credit, which has boomed by a 25%, in real terms, in the first half of 2003. It is noticeable that despite this big rise prudential indicators are still in safe territory. Lately, the Central Bank has adopted a series of measures aiming at restraining the upsurge of this credit –as a sort of preemptive policy.
- **The non-financial sector** has also developed rapidly, and the best indicator in this regard is the market capitalization of the Bucharest Stock Exchange: from 1.04% of GDP in 1999 and 3.3% of GDP in 2001, it has climbed to 6.05% of GDP in 2002 and 7% of GDP in the first half of 2003.

Fig. 4. Key prudential indicators in the banking system

	1999	2000	2001	2002	2003 Jul
Solvency rate (>12%)	17.9	23.7	28.8	25.0	22.8
Bad loans, as % of total assets	2.36	0.29	0.32	0.23	0.42
Credit risk rate	35.4	3.8	2.5	1.1	3.9

Source: NBR Monthly Bulletin 7/2003

2.2. How does Romania fare comparatively?

It is instructive to compare the current state of the Romanian economy with the situation in other EU candidate countries when they received the status of "functioning market economy". The data in the tables below are comparable in most respects. If the same standards operate in the judgement of economic performance, Romania can be given serious consideration for an upgrade. One could argue that judgements evolve over time and that they are more severe nowadays in view of recent years' developments both inside and outside the Union. This is not an argument to dismiss out of hand; on the other hand, how can one reconcile such a line

of reasoning with, for instance, recent years' ballooning budget deficits of some countries which are to join the EU in 2004?

Fig. 5. Private sector's share in selected accession economies

	Private sector, % GDP		Private sector, % employment	
	1997	2001	1997	2001
Hungary	65*	80		
Poland	60*	65	65*	70
Bulgaria		71*		73*
Romania		67		70

* At the time when it was declared a functioning market economy

Source: OECD and World Bank data

Fig. 6. Key macroeconomic indicators, selected EU candidate countries, at the time the European Commission considered them "functioning market economies" – as compared to Romania before the Commission's 2003 Country Report

	Cz 97	Hu 97	Pol 97	Sk 00	BUL 02	Ro 03
GDP,% annual real growth	1.0	4.4	6.9	2.2	4.8	4.8 (proj)
Inflation rate, % Dec/Dec	10.0	18.3	13.2	8.4	3.8	14 (proj)
Unemployment rate, %	5.2	8.1	10.3	17.9	17.4	6.6 (Aug 03)
Current account deficit, % GDP	-6.1	-2.2	-3.2	-3.7	-4.4	-4.8 (proj)
Budget deficit, % GDP	-2.2	-4.6	-3.1	-6.7	-0.6	-2.7 (proj)
Gross foreign debt, % GDP	41	63.1	28	37.3	71.9	33.0 (end 02)
Official gross foreign reserves, in months of imports	4.9	5	5.9	3.7	5.3	4.7 (Sep 03)
M2, % GDP	67.3	39.4	38.2	66.0	43.3	24.7 (end 02)

Note: all projections for Romania are those of the Government, and are endorsed by the latest IMF country analyses. Source: European Commission, IMF, national statistics

There are countries which have registered sharply deteriorating economic indicators (budget and current account deficits) in the last couple of years, quite ahead of their forthcoming year of accession, in 2004 – for instance: Hungary, Poland, Czech Republic. During this period Romania' economic performance has visibly improved. This state of affairs has not been unnoticed by the main rating agencies, which have improved Romania's standing during the spring of 2003. Most recently, Standard and Poor's

raised it to BB. Romania's rating is still under investment grade, but prospects for further positive revisions are deemed fairly high⁵.

Fig. 7. Latest economic data from selected EU candidate countries

	Cz	Hu	Pol	Sk	Bul	Ro
GDP,% annual real growth	2.2 (Q1 03)	3.6 (03 IMF proj)	1.3 (end- 2002)	4.4 (end- 2002)	5.0 (03 IMF proj)	4.3 (H1 03)
Inflation rate, % Dec/Dec	1.8 (end 02)	5.3 (03 IMF proj)	0.8 (end 02)	3.4 (end 02)	-0.2 (Q1 03)	7.3 (8m 03)
Unemployment rate, %	8.9 (end 02)	6.0 (03 IMF proj)	18.1 (end 02)	17.8 (end 02)	15 (Q2 03)	6.6 (Aug 03)
Current account deficit, % GDP	-6.5 (end 02)	-4.8 (03 IMF proj)	- 3.6 (end 02)	-8.2 (end 02)	-10.2 (Q1 03)	-4.8 (03 IMF proj)
Budget deficit, % GDP	-7.25 03 IMF proj	-6 03 IMFproj	- 5 03 proj	-4.5 (2002)	0.3 (Q1 03)	-2.7 (03 IMF proj)
Official gross foreign reserves, in months of imports	6.1 (Q1 03)	3.8 (03 IMF proj)	8.3 (end 02)	5.9 (end 02)	5.2 (03 IMF proj)	4.7 (Sep 03)

Source: IMF, national statistics

Fig. 8. Credit ratings, Standard & Poor, countries' sovereign fixed income long term debt, as of October 1st, 2003

	Local currency		Foreign currency	
	Rating	Evolution	Rating	Evolution
Romania	BB+	Positive	BB	Positive
Bulgaria	BBB-	Stable	BB+	Stable
Czech Rep.	A+	Stable	A-	Stable
Cyprus	A+	Stable	A	Stable
Hungary	A	Stable	A-	Stable
Lithuania	A-	Stable	BBB+	Stable
Poland	A	Negative	BBB+	Negative
Slovak Rep.	A-	Stable	BBB	Positive

Other indicators, capturing the deep structural characteristics of CEE economies, also offer an interesting view, as on many dimensions Romania is not necessarily the outlayer. Labor costs as a share of per capita GDP revolves around the regional average, unlike in a few other countries where they appear to be unsustainably high (Fig. 9). The large agriculture sector is indeed inefficient, but not more than Poland's – in this respect Bulgaria fares

⁵ Analysts from leading investment banks consider that, in spite of these upgrades, rating agencies continue to underrate Romania's performance ("Sovereign Eastern Europe Update, Bear and Stearns, 26 June, 2003)

indeed better than the other two countries, while in Hungary the agriculture is virtually as efficient as the rest of the economy (Fig. 10). The energy consumption per one dollar of GDP, a fair measure of the advance in restructuring a post-communist economy, is lower in Romania than in Bulgaria, though higher than in other CEE countries which have moved faster towards energy efficiency (Fig. 11). And the deviation from the world prices expressed by the purchasing power parity (how much more similar goods one can buy in one particular country with 1\$ than in USA) also show that Bulgarians face the longest way until they catch up with the rest of the world (Fig. 12).

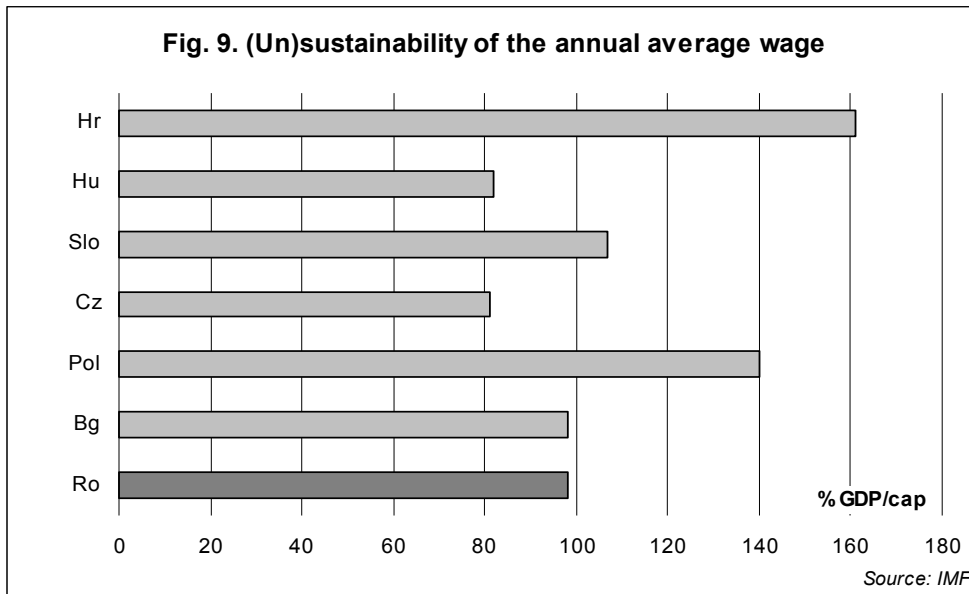
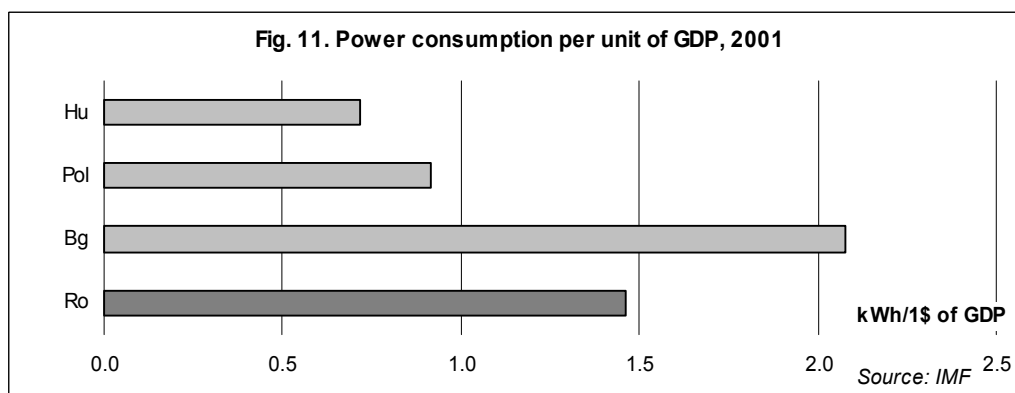
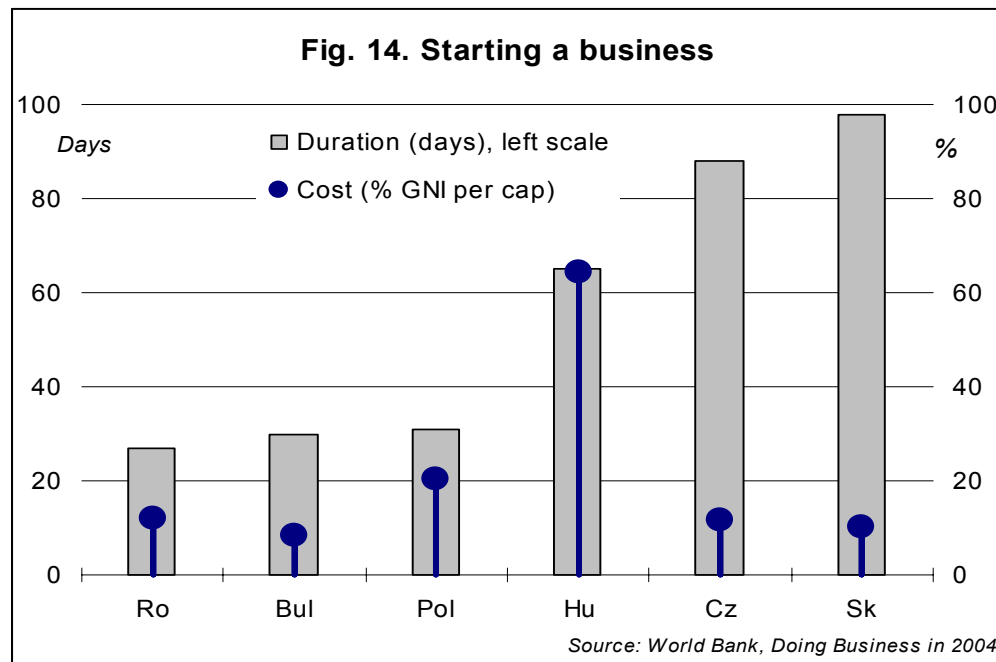
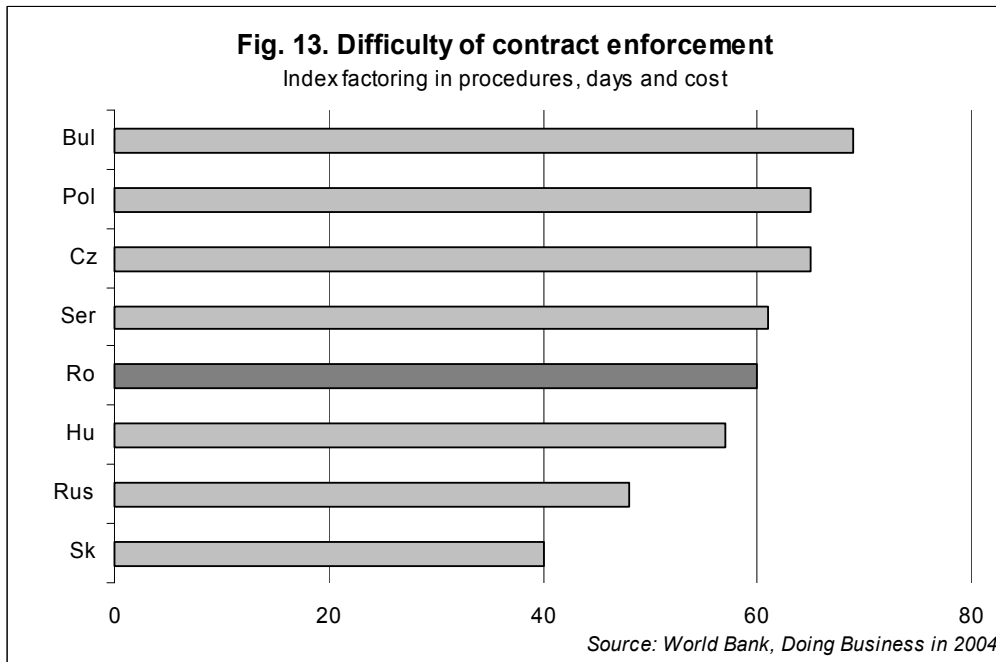
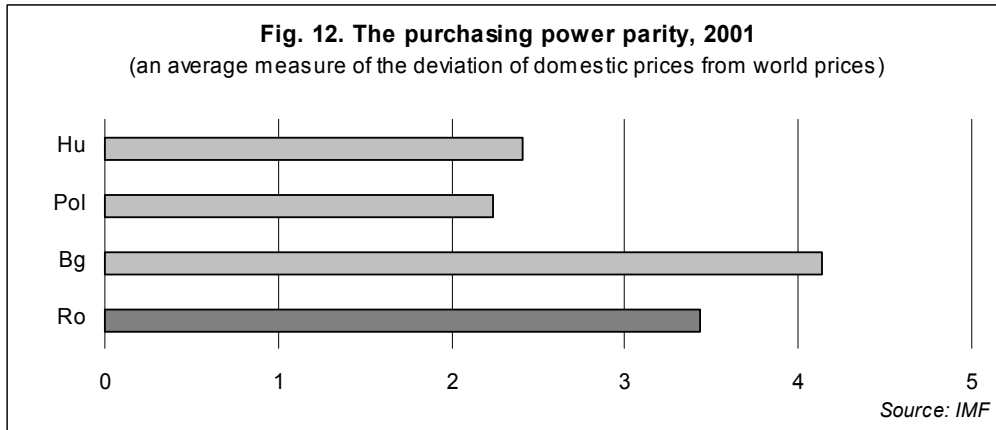


Fig. 10. The efficiency of the agricultural sector

	Ro	Bg	Pol	Hu
Agriculture, % employed	42	27	18	6.2
Agriculture, % GDP	15	13	5.1	6
Agriculture efficiency: GDP share/employment share	0.36	0.48	0.28	0.97

Source: IMF





The overall picture emerging from these comparisons is therefore more nuanced than that offered by the annual reports of the Commission.

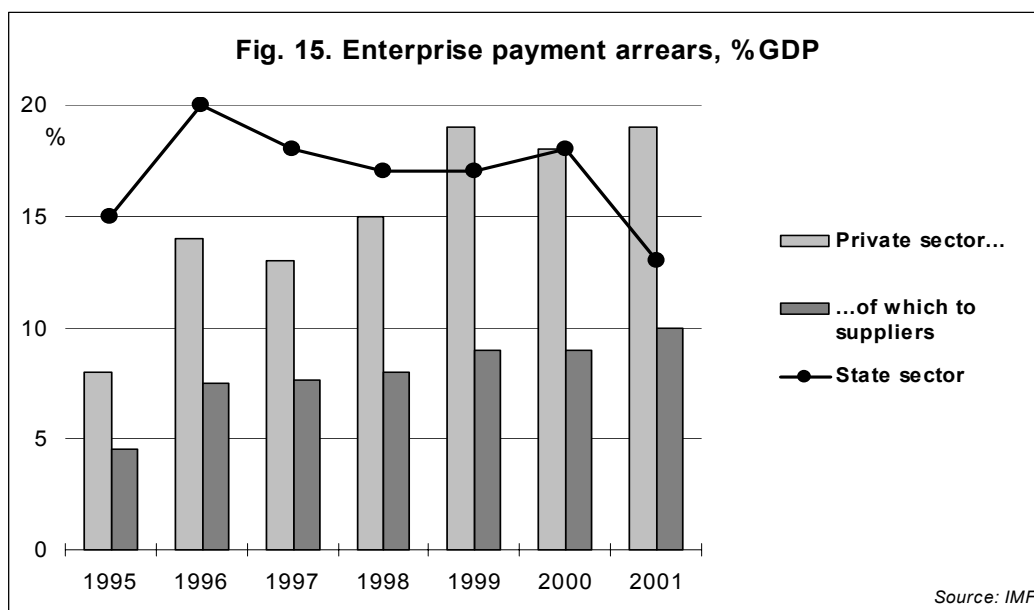
- There is a heavy burden of rural underdevelopment in Romania and Poland, with Bulgaria performing surprisingly better in this respect. However, in Poland agriculture and the pension system appear to be used less than in Romania as safety valves against unemployment.
- Privatization has advanced faster in Bulgaria than in Romania, especially since the current government took over in Sofia. In combination with the tight monetary policy of the currency board, it has led to the current perception of better macro stability and reformist drive. The latest move by Bucharest to privatize some loss-making companies, after years of feet-dragging, is probably too recent to have trickled into the regular reports of international observers.
- By contrast, the alignment to world prices seems to be more advanced in Romania than in Bulgaria. Most probably, this is the case with energy prices that were liberalized faster in Romania. As a result, the Romanian economy appears to be more energy-intensive today, though still behind those of the first-wave countries.
- The business environment has improved in Romania lately, at least on the indicators measured by World Bank and reported in a recent study: contract enforcement seems to be no more difficult than in other “market economy” countries; while starting a business has become relatively easy and cheap (Fig. 13-14).

2.3. What clouds the sky?

Romania's economic track record after 1999, when the country fended off the threat of a Bulgarian-style crisis, is very patchy, however. As already mentioned, major weaknesses persist which could harm GDP growth and macroeconomic conditions unless reforms go on. This caveat does not refer to unavoidable business cycle related fluctuations, but to an imaginable relapse into a combination of revived inflation and balance of payments difficulties. The current poor financial discipline and the unfriendly investment climate in Romania have been repeatedly stressed by observers as risk factors, and a number of government initiatives were aimed at improving things lately.

- **Inflation** is still high and has in the past been used by many companies as a means to survive. The current disinflation puts pressure on the loss-making sector and, in absence of bolder restructuring, large quasi-fiscal deficits would clobber the budget in the years to come. The persistence of these deficits would question the suitability of moving fast with the liberalisation of the capital account and the adoption of inflation-targeting in the near future. Although adding quasi-fiscal deficits to the official public budget deficits has its own methodological flaws – this is how the actual “consolidated” public deficit is measured most of the time – ignoring or underestimating them would be a serious mistake.
- Related to the point above, **financial (including fiscal) discipline** is not enforced consistently and loss making companies produce sizeable arrears / quasi-fiscal deficits. This is especially the case in their relationship with the energy sector, where the losses amount to about

1.5-2% of GDP. Arrears (losses) are also significant in the petrochemical industry. Also concerning is the fact that the arrears generated in transactions between private agents are on the rise and soon will overcome those generated by the state sector, which was predominant in the early '90s (Fig. 15). It is true that the total arrears declined in real terms lately, including in the energy sector, and the budget deficit has been capped at 3%. However, these goals should not be achieved by hiding twice the amount of the deficit in various dark corners of the economy, as the director of World Bank mission in Romania recently pointed out. He estimated the current quasi-fiscal deficit to around 2-3% of the GDP, an unsustainably high level, and argued that the problem is kept under the lid since no official data are published on these issues and the public is not properly informed.



- In spite of the recent improvements in **the business climate** mentioned above, red tape and corruption remain major concerns. What is more, while all the recent measures look impressive on paper, the changes for the better in the actual investment climate hinge fundamentally on how all these normative acts and regulations will be enforced – for enforcement is, like in other transition economies, the critical element in fostering real change.
- **The pension system** is increasingly under strain. The system is unbalanced, with much of its financing coming from the health insurance's budget, a fact usually denied by the government. The problem is chronic, because the retired population exceeds in number the employees (the ratio is nowadays 3:2, as compared to 1:2 in the early nineties). Public authorities seem only now to move closer to a real reform, after the abolition in early 2001 of the private pension laws adopted by the previous government. The accumulating of hidden deficits in the pension system, in parallel with a low and steadily declining employment rate, is not good omens for a would-be market economy.

- In the **energy sector** Petrom, the national oil company, is slowly advancing towards privatization, and so are two branches of the national electricity provider and two gas distribution companies. However, the general perception is that too little is done, and too late, as the government will soon enter the last year of its mandate. True, the energy sector poses specific problems because it needs large investments, while the interests of potential investors have to be reconciled with the protection of numerous low-income individuals. Moreover, as the experience worldwide indicates, energy markets need effective regulation, for market failures can be especially damaging in this area. But none of these arguments can be an excuse for foot-dragging and letting state energy companies become suppliers of soft credits, like the banks which eventually went bust six or seven years ago.
- The same bold reforms are also needed in **the mining and railways sector**. When the fourth and final instalment from the current agreement with IMF was approved in October, thus completing the first of six such agreements since the fall of communism, the result was achieved only with four important waivers included. The general impression was that Romania has gasped over the finish line rather than run a brilliant race.
- There are also important **“legacies” of delayed reforms** from PSAL program with the World Bank, such as the unfulfilled promise to sell BCR, the largest Romanian bank, and CEC, the savings bank. It is true that the lack of interest from strategic investors made the privatization slow and difficult. But whatever the reason, this is another point on which Romania compares defavourably with Bulgaria, which has fully privatized its banking sector and insulated it from political intervention. As things stand PSAL II can only be concluded by rolling over the “legacies” into the new PAL program currently negotiated with the Romanian government.

The problems highlighted in this brief analysis cannot be dealt with rapidly, since most of them are structural. Some of them do not even pertain to Romania only; they loom large in other accession (and not only) countries as well. For instance, agriculture has already strained Poland’s accession negotiations; likewise, the crisis of the pension (welfare) systems shows up increasingly in all accession countries and in the Euroland, too.

What is specific to Romania, however, is the rapid growth in the last years of a para-legal network economy which came to represent a substantial share of the private sector. Its core consists of a group of powerful businesspeople who have built their companies either as startups or, more often, in the privatization process, using political connections. In this sense, they are more political than economic entrepreneurs. The lists of companies high on public debt published by the Department of Finance after public pressure contains almost all the big names of Romanian business with huge sums. The difference between independent entrepreneurs and state captors is easy to be traced in their treatment, also published by Department of Finance: the former are forcibly pursued, the latter have their debts ‘rescheduled’. The latter includes Corneliu Iacobov, the brothers Micula, Tofan Group, and practically all the private electronic media. What would remain of these fortunes and businesses had they finally need to settle their debts? Some of these people have been directly involved in the privatization process before becoming fully private: one can notice

The real danger: the para-legal network economy developed by predatory elites

immediately that after they take over a state owned enterprise its performance does not get any better – and sometimes gets worse. Such entrepreneurship explains in part the increase in arrears generated by the private sector (Fig. 15). Second, their influence goes much beyond the actual share of assets they own in the total economy, since these people have become trend-setters. Their success and impunity encourage every entrepreneur to try to emulate such successful role models. Various industries such as oil refining and retailing, constructions, tourism or agro-businesses have been partly captured by the para-legal network economy, but other sectors suffer too. Their influence is so strong that even in those rare occasions when infringements of laws are blatant and widely known to the public – as it happened recently when football clubs, mostly owned by the same group of people, were found that they did not pay any tax or social contributions towards the lavish salaries of their players, and frankly admitted it – the authorities cannot muster enough courage to act, apply penalties and recuperate the debt.

III. Social

MIGRATION: FEARS ARE EXAGGERATED

Western media abounds in horror stories about Romanian migrants who trespass local residence rights, work in the black economy, and form criminal networks, engaged in stealing, prostitution or beggary. These stories are readily taken over by the Romanian media, which usually emphasize the Roma ethnic origin of many of the culprits. This game has been going on for a number of years, but recently the situation has taken a turn for the worse, with separate media reports that the French and Austrian government respectively are considering the re-introduction of visa requirements for Romanian citizens. While officially denied, these rumours have nevertheless stirred anxiety in Bucharest, and the matter was raised during the visit of the Romanian Home Secretary to his French counterpart.

(Illegal) Migrants

Romania was the last CEE applicant to have visa restrictions lifted in 2001 by Schengen countries. The decision came only after the newly elected Romanian government had convinced the European partners of its ability to secure the external borders, and reversed the prior government's policy by accepting the repatriation of asylum seekers expelled from Germany. The benign impact, in terms of migrant inflow, of abolishing visas for Bulgarian citizens one year before has also smoothed the course for the decision on Romania.

However, problems showed up pretty soon. After visa restrictions were lifted, the number of Romanian adults travelling abroad in 2002 was only up to 5% higher than in 2001⁶. However, media reports presented a much worse situation of Romanians working in the black economy, at times under the control of criminal gangs. Romanians became also involved in human trafficking, comprising prostitutes (mostly women, but also men), children, and lately disabled (employed for begging). Another widespread criminal activity consisted of networks of thieves, robbing shops and storages and re-selling the products in Eastern Europe.

While the number of people involved was not extremely high, prostitution and begging are visible activities for the media. However, there are also reports of large migrant communities in midsize towns, engaging in organized crime, and having a strong influence over the local authorities –

Trivial but visible petty criminality shape Westerners' perception of Romanians and Bulgarians

⁶ Romania, *Annual Early Warning Report*, 2003, Romanian Academic Society, <http://www.sar.org.ro/pwr>

e.g. Castellon, in Spain, where the Romanian community numbers as many as 10,000 people.

The situation appears to have reached a crisis point in a number of EU member states. The Austrian home affairs secretary has publicly lashed at Romanian and Bulgarian governments, asking them to curb the criminal activities of their nationals, as a pre-condition of EU accession. He is reported to have mentioned that the re-introduction of visa requirements for Romanian and Bulgarian nationals is under consideration. The French authorities are also rumoured to contemplate a similar move in the case of Romania. Romanian authorities have acted swiftly. The home affairs secretary has visited France to engage his counterpart, and a senior official from the border police was dispatched to Vienna.

The numbers involved have declined lately. As Fig 1 shows, Romanian emigration peaked in the early 1990s, and registered fairly low flows afterwards. The situation is similar in Bulgaria, where another peak was recorded during the climax of the political and economic crises – see Fig 2. Bulgaria is a particular case because of its large Turkish minority. Many Turks fled the country after the fall of communism, since 1989, and most of them settled in Turkey. Fig 2 reveals that the Turkish minority represented the bulk of migrants the first years after the fall of communism. Leaving aside the minorities, both in Romania and Bulgaria migration is a cyclical phenomenon, with many migrants returning after a brief spell abroad, especially as things settled down in their native country.

Fig. 1. Romanian dwindling migrants

	Total population	Birth rate (per '000)	Mortality rate (per '000)	Emigrants (number of persons)
1981	22,352,635	17	10	
1985	22,724,836	15.9	10.9	
1989	23,151,564	15.8	10.6	
1990	23,206,720	13.6	10.7	96,929
1991	23,185,840	11.9	10.9	44,160
1992	22,788,969	11.5	11.7	31,152
1993	22,755,260	11.1	11.7	18,446
1994	22,730,622	10.9	11.7	17,146
1995	22,680,951	10.4	12	25,675
1996	22,607,620	10.2	12.7	21,526
1997	22,545,925	10.5	12.4	19,945
1998	22,502,803	10.5	12	17,536
1999	22,458,220	10.4	11.8	12,594
2000	22,435,205	10.5	11.4	14,753
2001	22,392,000	9.8	11.6	

Source: INSSE, Romania

Fig. 2. Gross migration out of Bulgaria

	General population	Bulgarian Turks
1989	218,000	218,000
1990	85,000	71,195
1991	45,000	32,164
1992	65,000	23,490
1993	54,000	
1994	64,000	
1995	54,000	
1996	66,000	
1997	44,000	
1998	52,000	
Total		344,849

Regarding the strong public opinion reaction in EU member states in spite of the relatively low numbers of immigrants, several explanations can be outlined. Firstly, the migration flows are not distributed equally, some countries being disproportionately affected. Among the EU member states, Austria bears the largest burden and Germany has the highest absolute number of CEE migrants⁷. This situation can be explained by proximity (Austria and Germany are the closest Member States for most of the CEE applicants), size (Germany) and wealth of their economies which seem to offer opportunities to prospective migrants. Apart from these easy targets, few other member states receive a disproportionately high influx of Bulgarian and Romanian migrants: Greece, the only member state bordering Bulgaria, and the Latin countries (Spain, Italy, France, to and a lesser degree Portugal) targeted especially by Romanians, due to the cultural affinities.

A second cause of the public outrage is the general EU-wide anti-immigration trend. The process was recently substantiated by anti-migrant outbursts led by extreme-right parties in Austria, France, Netherlands, or UK. In this context even centrist parties expressed views against immigration (e.g. Denmark). Public opinion trend, combined with highly visible crimes, associated with minorities such as the Roma, make a powerful political cocktail.

Aware of the gravity of the situation, the Romanian government put considerable effort into mitigating illegal migration. Romania had been severely criticized on justice and home affairs in the 1997 Report of the European Commission. Since then, much progress has been achieved. Romania transposed into domestic legislation practically the whole relevant *acquis communautaire*. Even so, the 2002 report found serious deficiencies in the implementation of these regulations. The issue of administrative

⁷ Migration models also predict these two states will receive about half of the CEE migrants after accession. Source: *European Union enlargement. Effects on the Spanish economy*, Carmela Martin, Jose A. Herce, Simon Sosvilla, - Rivero, Francisco J. Velazquez, 2002

capacity returns as a familiar shortcomings of Romania's compliance with acquis requirements in a number of fields.

Romania takes back all illegal migrants expelled by EU member states. They are banned from travelling abroad and in some cases even prosecuted. On the prevention side, Romanians willing to travel to EU are required to show they have the means to support themselves while in EU, and to pay for the return journey. At least considering the data available, these policies were successful: in 2002 the total number of people returned from the border doubled compared to 2001, while the number of persons expelled from EU to Romania declined (Fig. 3). The Romanian government is planning to further strengthen these rules.

Fig. 3. The fist 10 countries returning Romanians (1st Jan-31st May)

Top10 countries	2001	2002
Italy	638	1,056
Hungary	2,789	526
Germany	1,357	492
Spain	149	315
France	448	274
Belgium	220	253
Austria	378	173
Greece	501	136
Swede	14	38
Czech Republic	163	30
Total	6,657	3,293

Source: General Inspectorate of Border Police, Public Relations Division; August 2002

After accession

The key question to tackle is the trend in migration flows once Bulgaria and Romania joined the EU and all the travel restrictions ceased. Opinion polls suggest the migration potential is rather high. Around 3% of the CEE citizens are expected to migrate to the EU-15, mostly to Germany. However, half of them are likely to return to their native countries over the medium term. While the overall number of migrants can be considerable the pressure is expected to be manageable.

Migration models show that key variables in determining the volume of the migration flow are the income differential between the country of origin and the country of destination, and proximity. Romania and Bulgaria are the poorest CEE accession countries. Thus, the migration pressure will be stronger than the CEE average. A mitigating factor is the geographic distance between Romania, and especially Bulgaria, and the rich EU members. Neither Romania, nor Bulgaria borders any of the core EU states. Also, in Romania, even after the abolition of visa requirements, the percentage of people planning to find work in EU remained constant at 16-17% of adults. Of this number, only 5% acted on their intention, which represents the rate of labor force migration after 1990⁸. A specific Romanian feature – the cultural connection with the Latin EU – countries might spur

⁸ Romania, *Annual Early Warning Report, 2003*, Romanian Academic Society, <http://www.sar.org.ro>

towards these the Romanian migration out-flow. Greece, the only current member state bordering Bulgaria, already receives a large share of the Bulgarian migrants.

The issue of brain drain

The Romanian and Bulgarian opinion leaders fear that the accession to EU and liberalization of the movement of labour will result in an exodus of the well qualified elites. This brain drain is largely believed to be an impediment to development in the respective countries, but the evidence is mixed in this respect. Partly confirming the brain drain scenario are opinion polls in Bulgaria showing that people most likely to emigrate are rather young (18-29 years old), better educated (high school or university graduates), but single and unemployed.

However, there are a number of qualifications to be made. First of all, this phenomenon is already taking place, even without accession. German statistics have shown that CEE migrants are relatively well educated, with higher education attainment at least similar with either their national average, or that of the host country. These findings were also confirmed in other EU member states, for example in Spain. The difference is that the current labor market restrictions are forcing them to accept jobs below their qualifications.

Secondly, both Romania, but especially Bulgaria have a large number of educated people. The rate of participation in higher education is about the European average in Romania, and one of the highest in Bulgaria – see Fig 4. The economies of Romania and Bulgaria struggle to involve them all in the labor market, still many of these people are unemployed, or, more frequently, underemployed. Thus, even with strong migration of the educated elite, both Romania and especially Bulgaria will be able to cope.

Fig. 4. Share of the labour force with tertiary education (%)

	Last available data
Austria	8.6
Bulgaria	19.3
Croatia	13.8
Czech Rep.	10.7
Greece	22.9
Hungary	13.9
Poland	14.0
Romania	12.4
Slovakia	11.7
Slovenia	14.1

Data source: World Bank 2000, 2001.

Finally, brain drain does not necessarily have only negative effects. In some respects, Romania, and especially Bulgaria, over-produce college graduates, if we take into account the level of development in the two countries (expressed in PPP GDP). Allowing these people to emigrate could be beneficial for their careers and also for the national economies which can compensate for the investment in education through remittances. Remittances are already an important source for funding the current account deficit in Romania (larger than foreign investment) – Fig 5. Similar

“Brains” can emigrate easily anyway, and not necessarily to EU. If anything, enlargement may create conditions for them to stay home

data for Bulgaria indicates in 1998 remittances of 230 million USD, representing 3.8% of imports – these numbers, while considerable, are probably underestimated since the difficulties experienced at the time by the Bulgarian banking system encouraged people to rely on unrecorded cash transfers. Estimates of the National Bank of Romania for 2002 indicate about 2 billion dollars in remittances that have entered in this year alone.

Fig. 5. Remittances, volume and relevance, in the Romanian economy, 2000⁹

Total, mil. USD	% GDP	% exports	% imports	% FDI inflows	% foreign reserves*
1074	3.37%	10.36%	8.91%	100.8%	44.3%

*gold reserves not included

Transit countries

The most challenging consequence of EU expansion for Bulgaria and Romania will be their new status as gatekeepers of the Union. Once the 10 CEE new members will formally join EU in May 2004, Romania will become the immediate neighbor of the Union to control the flood of illegal emigrants trying to enter the EU space. Romania is actually at the crossroads of two major trafficking routes: one starting in Russia, Moldova, Ukraine, Romania, and then towards EU; the other is the southern route, coming from Turkey, Bulgaria, Romania, and EU. Failing to carry out this task would have dire consequences for Romania. The direct costs could be very high and its chances for accession to EU affected. The new EU approach proposed by the Italian presidency, is to expel illegal emigrants / rejected asylum seekers to the country of origin or to the last safe country passed on the way to the Union. After May 2004, this last safe country will be Romania.

The responsibility will be even higher after Romania's eventual accession, and liberalization of the movement of people. The Union has taken precautionary measures by requesting a five-year transition period for the free movement of persons. The Romanian government has heavily invested in up-grading the Eastern border and acquiring new surveillance equipment. Romania has introduced or is about to introduce visa requirements for Turkey and Yugoslavia. Despite special historical ties, at the moment of accession visa will be required even for Moldavians. The National Office for Refugees underwent a process of institutional consolidation. Fig 6 outlines that these measures brought results, with the number of foreigners denied entrance to Romania increasing. However, the capacity of border police and the issue of corruption are not yet resolved. Reportedly, the challenge is similar in Bulgaria.

⁹ Dăianu et al.; *Losers and winners in the process of EU integration. A look at Romania* ; Working Paper no 27/2001; RCEP

Fig. 6. Foreigners Not Allowed for Crossing In (NACIs)

Top 10 countries NACI (1 st Jan–31 st May)	2001	2002
R. Moldova	16,308	16,514
Hungary	6,534	8,576
Ukraine	2,577	2,532
Bulgaria	685	2131
Turkey	592	1,204
Yugoslavia	296	643
Germany	98	262
Italy	106	198
Bosnia-Herzegovina	25	178
Russian Federation	110	100
Total	27,331	32,338

Source: General Inspectorate of Border Police, Public Relations Division; August 2002

IV. CONCLUSIONS AND RECOMMENDATIONS

If Romania and Bulgaria are judged in a broader time perspective both countries have over-performed, not under-performed, during this transition. Their communist legacy was the worst; Romania's exit path from Communism, ambiguous and violent, was by all standards a bad omen for the development of a democracy. But democracy did develop in Romania, which enjoys a lively and self-assertive civil society, with media and NGOs struggling for a culture of transparency. The recent resignations of powerful ministers accused of corruption solely by the Romanian civil society shows that accountability works in the country, that Romania is able to handle its own problems.

The main problem of Romania under the current government, unlike Bulgaria, is that the most important drive of change is still foreign pressure. The main agents of change in Romania continue to be IMF, World Bank and the European Commission. As this report shows in the fields of judiciary and administrative reform, there is practically no government will to improve radically these sectors where conditionality is hard to monitor and enforce. More determination is clear in the macroeconomic policies, where the Ministry of Finance does function as an active actor for change. Unfortunately, as it showed in the case of fiscal reform, there was not enough political support in the government party to back up the good policies of one Ministry.

The year ahead is a challenging one on two accounts: it is the last year of EU negotiations, and there are also domestic elections. More support is needed from the government party for the new team empowered to act on EU accession, the goal which should subordinate all others in the next years. This means restructuring the government following the EU country report to increase speed and solve backlogs.

RECOMMENDATIONS TO THE ROMANIAN GOVERNMENT

GENERAL

- **The house should be cleared in a more timely manner next time. The lagging of Puwak and Beuran scandals in the media has hurt not only the government, but Romania's image abroad and EU accession. The press, including foreign press, had reported negatively for years on the General Secretary of government, Șerban Mihăilescu. These resignations come late, after a lot of damage was done. As SAR has recommended last summer (2002) a restructuring of the government should have taken place then, before the PM went public defending the dubious characters in his government and pledging he will not let them go. The cost paid by the PM is higher now than it would have been a year ago.**
- **The ministers whose sectors come out as laggards from the EC country report should also resign and be replaced with people who can prompt real change in the process. Especially in the field of *JUSTICE* the delay is**

serious, and the will to democratize the system is shaky. A change is badly needed. But the eventual successor as Justice Minister will also need more backup if things are to improve. There is also resistance to reform in the Parliament, and all the will of the government party needs being summoned to push this reform through.

- Empower the new Minister of European Integration and grant him more authority over other ministers. The way to improve policy cohesion is to locate it in the Ministry of European Integration.

JUDICIARY

- Make public the draft law on the Superior Council of Magistrates and discuss it openly with international donors and Romanian civil society. Accept the democratization of elections for the positions of judges members of the Council.
- Give up all pending extraordinary appeals in property-related cases and pull out from the property related trials at ECHR. Better act elegantly and timely than lose all the trials as the Romanian state has done so far. Live up to the spirit of the new Constitution just passed and restore property to owners.
- Give up the extra-ordinary appeal in criminal procedure. Restore the authority of the Supreme Court of Justice this way, or no constitutional reform can help.

HOME AFFAIRS AND FOREIGN AFFAIRS

- Prepare for the first elections with over one million Romanians abroad, and perhaps two millions. Improve communication with the migrants' community.
- Continue to act to strengthen borders and be more self-assertive and professional in selling the good performances in this respect to the national and international media.

TO INTERNATIONAL DONORS

- As the recent resignation of three ministers showed, the real drive for change in Romania is Romania's public opinion. Make all the commitments of the Romanian government, including diagnoses, recommendations and deadlines, public. This will foster both accountability and performance as the public opinion will monitor them for you.

TO THE EUROPEAN COMMISSION

- Consider granting the status of functional market economy to Romania sooner rather than later. In the same time improve control over spending of European funds in Romania and exercise strong conditionality regarding the cleaning of the Romanian economy of political entrepreneurs. Make European companies a less reluctant ally in the process, as far too often they still engage in unholy alliances to penetrate the Romanian market.

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