# Research Note:
# Romania and the IMF - The Effects of IMF Support on Economic and Social Policy in a Transition Country[1]

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## Abstract

This research project attempts to answer the question: How has cooperation with the International Monetary Fund (IMF) affected Romanian economic and social policy since 1989? The investigation proceeds by identifying the five main policy objectives identified in the current stand-by-agreement between Romania and the IMF and tracing the impact of IMF pressure in each of these areas: privatization, arrears, wage policy and financial discipline in the public sector, and the evolution of macroeconomic indicators. We have so far found that, even as IMF loan conditions cannot be claimed to have been satisfactorily fulfilled in any of these areas, with the exception of the current evolution of macroeconomic indicators, it also cannot be denied that conditions have been partially implemented in all the above-mentioned areas and have been at least minimally successful in all except the improvement of financial discipline in the public sector. The overall impact of cooperation with IMF has been to progressively (although not (yet) to the intended extent) align Romania with the so-called "Washington consensus" on economic policy, which is a crucial driving force in its current transnationalization.


## 1. Introduction

The study of the impact of cooperation with international organizations on the domestic politics of member or prospective member states falls within the general scope of the field of study of international socialization. Viewed from within this framework, international organizations may be understood as "nannies", which propagate the norms which are constitutive of and/or promoted by them through the use of carrots and sticks, different ways of improving and ensuring compliance of the actors, typically nation states, which are either members or aspire to become members of the organization.[2]

Another slightly different angle from which to approach the problem of the impact of international organizations on policy "at home" is provided by the field of study of "transnationalization," which takes a less actor-oriented and more of a bird's eye perspective on the spread of policies and decisionmaking procedures across national borders.[3] Viewed from each perspective, the spread of norms across borders, even though it may be initiated and materially supported primarily by transnational actors such as international organizations, in fact involves a network of actors at various levels,

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[1] This is a report on on-going research. It does not represent the final findings of the project, which are expected in early 2004. THIS IS A WORK IN PROGRESS.

[2] See, for example, Ronald Linden (ed.), *Norms and Nannies: The Impact of International Organizations on the Central and East European States* (Lanham, Md: Rowman & Littlefield, 2002).

[3] See, for example, James N. Rosenau's visionary *The Study of Global Interdependence: Essays on the Transnationalization of World Affairs* (London/New York: Continuum International Publishing Group, 1981) and Jean Grugel (ed.), *Democracy Without Borders: Transnationalization and Conditionality in New Democracies* (London: Routledge / ECPR: Studies in European Political Science 10, 1999).

including the support of crucially positioned domestic decisionmakers and publics. Support from an entire network of norm transfusion, involving actors which might hold very different motives for pursuing the same policy course, is necessary for such far-reaching policy adaptation as would serve to indicate the transnationalization of policy or the socialization of a new member into an international community.

This, then, is the main factor which complicates the study of the impact of international organizations on domestic policy: It is difficult to sort out which actor has how much impact on any eventual policy change (or lack thereof) observed. This difficulty is exacerbated in a situation in which the "nanny" of interest represents a substantial transnational consensus or majority position, as in the case at hand. IMF loan criteria link in large part with those of the World Bank as well as European Union (EU) accession criteria and the recommendations of a host of other international organizations and transnational as well as domestic actors to encourage policy adaptation in a particular direction: towards the "Washington consensus," which promotes far-reaching economic liberalization along with a host of more concrete measures to support it as well as the requisite establishment of representative liberal democracy with maximum separation of the public from the private sphere and minimum interference of the former in the latter.

The IMF is one of the most important international organizations for Romania. It is also one of the most embattled international organizations worldwide. Its critics blame it for the plight of collapsing economies like Argentina's.[4] Its defenders claim that such tragedies usually occur because countries listened to IMF recommendations too little, or too late. It should be in the interest of debtor nations like Romania as well as of the international community as a whole (consisting as it does of prospective debtor nations and quota contributors) to know more about the effects of IMF loan conditions, guidelines, and advice on domestic economies and social systems. Various studies, mostly concerning specific countries, very few taking a comparative perspective, have appeared in the attempt to elucidate the impact of the IMF's activity worldwide.[5] None to date have examined the impact of the IMF on economic and social policy in Romania in particular.[6] This research project seeks to fill this gap, and to develop conclusions which might also be relevant for other "problem countries" in post-communist transition.

Romania joined the IMF in 1972. Its quota in the organization amounts to 0.48% of total, which gives it a voting power of 0.49% of total. While it thus predictably has very little influence on IMF policy, it is much affected by it: Since 1972, Romania has entered nine stand-by agreements with the IMF. This research focuses on the period since 1989, when, after the overthrow of Ceausescu's totalitarian regime (which ran a planned

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[4] See, for example, Kevin Danaher, *10 Reasons to Abolish the IMF and the World Bank* (New York: Publishers Group West, 2002); James R. Vreeland, *The IMF and Economic Development* (Cambridge, UK: Cambridge University Press, 2003); and Richard Peet (ed.), *Unholy Trinity: The IMF, World Bank, and the World Trade Organization* (London: Zed Books, 2003).

[5] See, for example, Killick, Tony. *IMF Programs in Developing Countries: Design and Impact* (London: Routledge 1995) or James R. Vreeland, *The IMF and Economic Development* (Cambridge University Press, 2003).

[6] Liliana Pop has examined the evolution of Romania's cooperation with the IMF, but not its effects on policy ("Where the Domestic Meets the International: The Role of the International Financial Institutions and the EU in Romania's Post-Communist Transformations," *Romanian Journal of Society and Politics* Vol. 2, Issue 2, October 2002, pp. 158-187). Jan Aart Scholte has made some observations concerning the impact on Romania of the IMF as an agent of globalization ("Globalization, Governance and Democracy in Post-Communist Romania," *Democratization* 5, 1998, pp. 52-77).

economy), the IMF was first placed in a position to, alongside other actors, take part in shaping the nature of economic and social policy in the country. Since 1989, six stand-by agreements have been signed. Negotiations with the IMF to obtain and extend loans have been chronically difficult and no stand-by loan has ever been fully disbursed, because one or more conditions were always considered insufficiently fulfilled.[7] Nonetheless, by mid-May 2003, total credit and loans owed to the IMF amounted to SDR 363.4 million,[8] and cooperation continues, a sign that Romania must have gone along with IMF directives at least to some extent.

In order to understand the nature of the impact cooperation with the IMF can have on a debtor country, it is important to understand that the influence of the IMF is not necessarily proportional to the money owed to it. The sums involved can be rather small, as they are in the case of Romania. However, success in negotiations with the IMF, the approval of loans, and good performance in reviews have a crucial signaling function, which affects the country's credit ratings and thus its ability to borrow on international financial markets, the perception of its progress towards EU accession, as well as its judgment by other potential supporting organizations, such as, notably, the World Bank.

The main research question tackled in this project is: How has cooperation with the IMF affected Romanian economic and social policy since 1989? This is admittedly a very difficult question to answer. The sheer number of actors at different levels of governance which impinge upon the evolution of policy within any transnationalizing state, along with the lack of transparency of much of their activity, make it quite impossible to sort out their various influences with any certainty. It is impossible to accurately measure the amount of impact these various actors have on the shape of domestic policy, nor is it possible to ascertain the precise nature of their impact. The best we can do is to ascertain its direction and estimate its weight by employing a two-fold strategy: First, we can try to trace their influence within the domestic policy making system as carefully as possible, to shed light on the actual mechanisms and dynamics of norm transfusion through the system via the particular actor of interest. Second, we can, based on knowledge of the evolution of domestic policymaking and policy in the country under study over a reasonably long time period, attempt a comparison of the observed behavior of domestic policymakers with the counterfactual scenario in which no such "outside" actor has been active.

This study combines these two approaches, linking process tracing analysis[9] to shed light on the nature and evolution of IMF involvement in policymaking in Romania with a case study background which, based on extensive knowledge of the domestic political context, can estimate the rough level of impact this involvement has had by asking the question: What might economic and social policy in Romania look like today if it had not been for IMF involvement since 1989?

## 2. Approach and Methodology

[7] Much light has been shed on this process by Liliana Pop in "Where the Domestic Meets the International." As will become clear later on in the text, the current agreement might become the first to actually be completed.
[8] The Special Drawing Right (SDR) is the IMF's accounting unit. Currently, 1 SDR equals 1.4154 USD.
[9] In adopting this approach we follow the methodological suggestions made by Andrew P. Cortell and James W. Davis Jr. in "Understanding the Domestic Impact of International Norms: A Research Agenda," *International Studies Review* Vol. 2, No. 1, Spring 2000, pp. 65-87.

This research project has been designed to shed light on how its cooperation with the IMF has affected the course of Romanian economic and social policy development since 1989. This is a challenging question, because it is always difficult to say what authorities would have done if the protest or encouragement of the IMF had been absent. Nonetheless, by studying closely the interaction of successive administrations with this international organization, and by examining alternative positions within the domestic system, we can come closer to finding out how its cooperation with the IMF has actually affected economic and social policy in Romania. To this end, we have read policy documents, agreements, and news coverage and conducted interviews with the IMF representative, with relevant members of the Romanian governing and opposition elite, as well as with civil society stakeholders. While this research project has focused on Romania, we have also kept an eye open for information about other countries which, by means of comparison, might both shed more light on the Romanian case and help draw some more general conclusions from the single-case study attempted here.

The first step in our research process was to identify the IMF's basic and stable policy objectives for Romania. To maximize the contemporary relevance of the research, these were identified initially on the basis of the current stand-by agreement and reviews carried out in its context, that is by studying the documents, press releases, and media reports related to the current stand-by agreement (approval date Oct. 31st 2001; amount SDR 300 million). In addition to their being singled out as performance criteria in the current stand-by agreement, the policy objectives identified had to fulfill the following other criteria: They had to

1. be important for domestic politics in Romania, as reflected in the media;
2. reflect a lasting concern (visible since 1990);
3. be specific enough to constitute a manageable research focus.

Together, the policy objectives thus identified had to be judged representative of the IMF's involvement in Romania or, put differently, of its overall socialization effort.[10] This is how summing up our findings related to impact in these policy areas will allow us to draw conclusions about the overall direction of the impact of IMF involvement in Romania. Assessing the extent of this impact is a secondary objective.

Using this strategy, the following policy objectives were identified:

1. the objective to drive forward the **privatization** of state-owned enterprises (also referred to as "restructuring" and "structural reform" or at least as a component thereof). The currently most publicized cases in this area are Banca Comerciala Romana (the Romanian Commercial Bank; a case of privatization in progress), Resita steel company (a case of failed privatization, renationalization, and currently attempted reprivatization), and Petrom oil company (being readied for privatization).
2. the objective to improve the collection (and minimize the continued accumulation) of inter-company **arrears**. This includes the improvement of collection of receivables owed to utilities companies (which are state-owned) and specifically the collection of utilities payments owed by money-losing state-held enterprises (which have been kept operative by means of impromptu exemptions or by tolerating unpaid debts, especially to the state budget).

[10] Of course IMF officials might not view their task as one of international socialization, not are they likely to consider themselves "nannies."

3. the objective of disciplining **salary policy** in the public (or state-controlled) sector, meaning in both state-owned enterprises and the public administration. A focus for our study here are 84 state-held companies currently placed under a special governmental monitoring program.
4. the more general objective of improving **financial discipline in state-owned enterprises** (which is considered another aspect of restructuring and frequently a prerequisite for successful privatization).
5. the objective of improving **macro-economic indicators**, which reflects the IMF's official focus on the aim of macroeconomic stabilization.[11] Main specific objectives here are to increase growth (GDP), lower the inflation rate, optimize crucial exchange rates, minimize the budget deficit, and consolidate currency reserves.

While we do not employ a hypothesis-testing research design, simply because the operation of a wealth of explanatory variables combined with their lack of susceptibility to quantification does not allows us to properly test specific hypotheses linking IMF involvement to particular policy outcomes, the expressed policy objectives listed above help us to assess to what extent there has been an intended impact of IMF intervention in each policy area. Our aim in assessing this impact is primarily descriptive, that is, we are interested in seeing what this impact looks like. Our approach, simply put, is to select representative areas of IMF involvement and look at what the IMF tries to do in each area and how Romania responds to these efforts. Our method is, largely, process-tracing analysis through heuristic case studies. We have focused our investigations on specific cases for the sake of process-tracing but also study the entire relevant context with respect to the policy objectives listed above. The goal is to identify the impact of the IMF's promotion of its stated policy objectives in each area on the relevant economic and social policies and then to draw general conclusions about the nature of the impact of IMF involvement on social and economic policy in Romania overall. Once again, we are interested primarily in the direction of this impact, and only secondarily in its extent, which is more difficult to assess due to the involvement of other relevant actors.

In conducting the separate investigations of each area of policy intervention we have striven to:

1. understand the rationale behind the policy objective;
2. know what has been done by the IMF since 1990 to further this objective;
3. see how Romanian governments have responded;
4. focus specifically on effects on economic and social policy.

When assessing effects on policy, we have been interested in formal as well as behavioral impact, meaning in changes in legislation as well as the extent to which such changes were implemented and became reflected in subsequent policymaking. The following five sections will analyze each policy area in turn.

## 3. Privatization

Privatization is the process of transformation of state-owned enterprises into privately-owned companies. This means that the public share of the company heretofore held by the state is transferred into private property. In Romania the process of privatization is regulated by Law no. 158 (14 August 1991) and all other laws and

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[11] Interview with Graeme Justice, IMF Resident Representative in Romania, Bucharest, May 9th 2003.

ordinances passed by the Parliament and issued by the Government which complete this law.

The specific questions we have tried to answer with respect to the impact of IMF involvement on privatization in Romania are:

- How might privatization have gone in Romania if the IMF had not been involved?
- Why is privatization important for the IMF? What are the reasons behind this policy objective?
- How has the privatization of two specific cases of contemporary importance (Banca Comerciala Romana and Combinatul Siderurgic Resita) evolved until now?[12]

It is not easy to measure the importance of agreements with the IMF for Romanian social and economic policy (especially with respect to privatization) because there are many other factors (or variables) which can influence these policies (like the preferences of successive Governments and Parliaments, the constraints emanating from the current Romanian economic and social system, public opinion, or other external actors, such as the EU or the World Bank). Still, it is very likely that there has been some influence by the IMF in this area, since the condition of driving forward privatization is present in all the agreements between Romania and the IMF since 1992 and because privatization is an issue which strongly preoccupies Romanian authorities (as can be seen in the activity of the principal institution for privatization: APAPS – the Authority for Privatization and Administration of the State's Shareholdings).

In trying to answer the questions above, we have analyzed all agreements between Romania and the IMF since 1992,[13] consulted the relevant documents published by APAPS and the IMF, monitored the Romanian press, and conducted interviews with IMF and APAPS officials. The main limitation of our research in this area has been that we have not been able to conclusively link the conditions related to privatization stipulated in IMF agreements with their accomplishment by the Romanian Government. Even though the agreements specify the domains and sometimes the number of the companies which should be privatized, and even though we could find some partial data on the number of companies privatized (since 1996), that does not mean too much, for the following reasons: First, it cannot be said that the companies privatized are the same as those referred to in the agreements; second, other programs were entered into with the World Bank (PSAL I and II as well as earlier programs), which were more important for the Romanian officials. As Graeme Justice, IMF Resident Representative in Romania, confirms, "Privatization is more the business of the World Bank; the PSAL I already includes the entire privatization schedule."[14] The IMF tends to operate within the privatization policy framework developed by the World Bank. In terms of specific competencies, it holds more relevance and is more actively involved in banking sector restructuring. However, conditions related to privatization are included in all the stand-by agreements between the Romania and the IMF, and the IMF considers itself to "back up"[15] the World Bank's privatization drive.

[12] At this stage in our research, we have not yet progressed sufficiently in our analysis of the Petrom case to present preliminary findings.

[13] Agreements between the Romanian Government and the IMF have the status of treaties and must be ratified by the Parliament. They can therefore all be found in the legislative archives of Romania, the *Monitorul Oficial*.

[14] Interview with Graeme Justice, May 9th 2003.

[15] Interview with Graeme Justice, May 9th 2003.

Since 1992 the stand-by agreements have tended to become more and more specific concerning conditions related to privatization. The first memorandum only makes general references to privatization, while the recent ones tend to include specific criteria for successfully pursuing it. In the following pages we will briefly outline the relevant criteria drawn up in the successive stand-by agreements.

**1992 Memorandum Regarding Enterprise Reform and Privatization**[16]

- The Government considers that the privatization of the state-held shares is essential for the construction of a functional market economy, for the re-enforcement of the financial discipline of enterprises, and for increasing the efficiency of enterprises.
- The Law on Privatization of 1991 asks for the privatization of 6,000 state-owned enterprises.
- Until the end of the first half of 1992, 400 companies will be sold. Also, the Government will continue the selling of houses and the distribution of land to the population.
- It is also stipulated that the Government aims to shut down all inefficient state-owned enterprises.

As can be seen, this agreement stipulates some incipient conditions and tasks assumed by the Romanian officials.

**1994 Memorandum Regarding Privatization**[17]

- The Government and the Romanian National Bank (BNR) will adopt a strategy of privatization and restructuring of the commercial banks. The restructuring of the banks will be realized on the basis of some detailed studies conducted by independent consulting firms. The plans for restructuring also include plans for the privatization of two state banks by 1995.
- The memorandum includes references to what has been done by the Government up until this point: the sale of the majority of houses to the population; the privatization of almost all agricultural cooperatives (80% of usable land in private hands); the Private Property Fund (FPP) has, by the end of 1992, distributed deeds to 95% of the 18 million citizens who had the right to receive them; the FPS (State Property Fund, the predecessor of APAPS) was founded as an institutional organism designed to accelerate the privatization process.
- The FPS divides enterprises into three categories dependent on their size: small enterprises are to be privatized through the Management and Employees Buy-Out (MEBO) method (selling the public share in the enterprise to its employees); medium-sized enterprises (2,850) are to be privatized with the help of FPS and FPP; FPS and FPP will also have to deal with the privatization of the large enterprises and banks on a case-by-case basis (in the first 10 months of 1993, the FPS published three lists with 100 medium-sized and large companies to be privatized).
- The goal of the Romanian Government at that time was to privatize 1,930 small enterprises (with a capital of 280 billion Romanian lei (ROL)), 403 medium-sized

[16] Law 64 (July 8th 1992), regarding the stand-by arrangement between the IMF and the Romanian Government (in *Monitorul Oficial*, no. 161, July 14th 1992).
[17] Governmental Ordinance 4 (February 9th 1994), regarding the stand-by arrangement between the IMF and the Romanian Government (in *Monitorul Oficial*, no. 47, February 23rd 1994).

enterprises (with a capital of ROL 443 billion), and 35 large enterprises (with a capital of ROL 442 billion), until the end of December 1994.

- The Romanian officials estimated at the time that 10% of the state-owned enterprises would be privatized by the end of 1994.

**1997 Memorandum Regarding Privatization**[18]

- The goals mentioned in this memorandum were presented as structural criteria. The following were the structural criteria for the second review of the program's results (cumulated): the liquidation or privatization of 45 chicken and pig farms; the privatization of 75% of the state-owned intermediary companies; the privatization of eleven state-owned companies with big losses; the privatization of a cumulated number of 3,600 enterprises; the privatization of BRD (the Romanian Development Bank).

**1999 Memorandum Regarding Privatization**[19]

- The memorandum refers to Romania's structural reform program with the World Bank (PSAL I), which includes privatization criteria: the liquidation of 40 companies which represent 5% of the state's losses and the privatization of some enterprises which represent 7.7% of the state's losses.
- Regarding what has been done by the Romanian Government since the last memorandum, it is specified that in the first part of 1997 585 enterprises were privatized (35 of them large). These enterprises represented 5.7% of the capital of FPS, compared with the privatization of 8% of FPS capital in 1998 and 10% in the period 1990-1997.

However, despite this acceleration of privatization (Romtelecom, BRD, and Banc Post are given as examples of successful privatization), the general trend was still disappointing. This was the reason for Romania and the World Bank to try some new methods of privatization: the privatization of 50 enterprises by the "package method" (metoda "la pachet"); the privatization of 9 large enterprises by the case-by-case method (enterprises which represented 7.8% of FPS capital); the initiation of restructuring or liquidation of 5 large enterprises by the same method (which represented 6.4% of FPS capital); and the continuance of the direct process of privatization (for enterprises which represented 14% of FPS capital) until the end of December 1999.

**2001 Memorandum Regarding Privatization**[20]

This memorandum also refers to Romania's privatization program with the World Bank (PSAL II). This agreement includes the terms and conditions for the privatization of BCR (the Romanian Commercial Bank). The Bank should have been sold to a strategic investor by the end of 2002. This did not happen because none of the potential investors fit the criteria. The investors expected to show interest in BCR did not appear. As

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[18] Governmental Ordinance 30 (August 25th 1997), regarding the stand-by arrangement between the IMF and the Romanian Government (in *Monitorul Oficial*, no. 215, August 28th 1997).
[19] Governmental Ordinance 76 (August 30th 1999), regarding the stand-by arrangement between the IMF and the Romanian Government (in *Monitorul Oficial*, no. 422, August 31st 1999).
[20] Governmental Ordinance 147 (November 9th 2001), regarding the stand-by arrangement between the IMF and the Romanian Government (in *Monitorul Oficial*, no. 748, November 23rd 2001).

Graeme Justice notes, privatization in the Romanian banking sector now suffers from a general “downturn of interest:” “Romania missed the boat. … The Romanian Government could have got very good prices a few years ago.”[21]

Now the privatization of BCR will be achieved through a “buy-back”[22] system involving the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC - the investment arm of the World Bank). The two investors combined will buy 25% of BCR’s share capital and when the Romanian state finds a strategic investor these public shares will be sold back to the Romanian state. The involvement of EBRD and IFC in BCR’s privatization significantly improves the chances of getting a “first-rate international bank interested.”[23] Officials at APAPS “regard the deadlines set up in the negotiations with the IMF optimistically”[24] and “believe that there are reasons to think that the transaction with EBRD and IFC will be finished by the end of July 2003.” This will lead to “private” majority control of the bank, because EBRD, IFC, and the other investment houses involved will then hold 63% of BCR’s capital.[25]

The privatization of BCR will be atypical because EBRD and IFC are not actually private financial companies. It is expected that the involvement of these two organizations will raise investor confidence and interest in buying BCR and in the meantime also improve the management of the company. Improving the chances to find a suitable investor for one of the Romanian states’ main assets is the main, and according to the IMF, also a good reason to delay the privatization of BCR.[26]

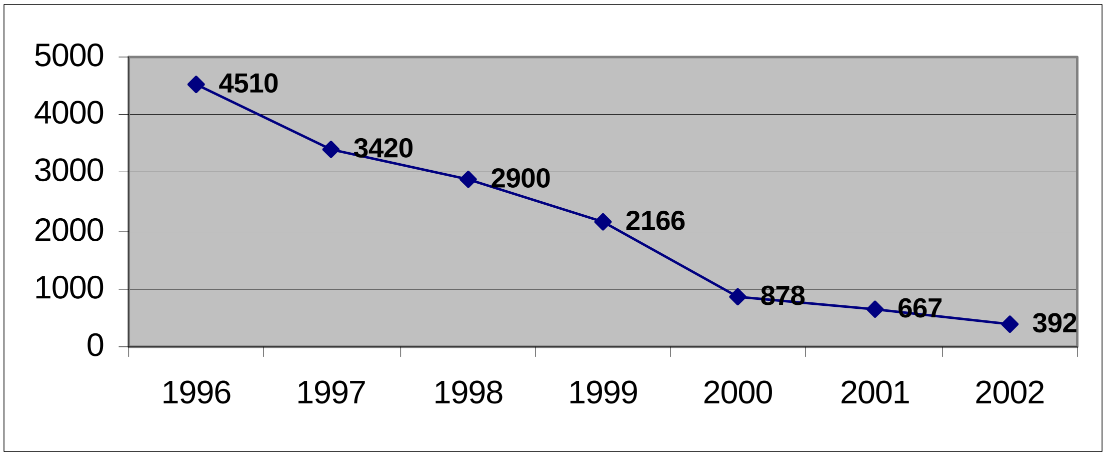
Returning to the 2001 memorandum, the Romanian Government states the following goals: to implement measures of reform for two other state-owned banks: CEC and EXIMBANK (in accordance with the roadmap for accession agreed upon by Romania and the EU). The program also includes the “promise” to privatize at least four companies with more than 1,000 employees until the end of October 2001, another four until the end of December 2001, and another four until the end of March 2002; it also promises the commencement of legal procedures for liquidation of at least 15 inefficient enterprises until the end of October 2001 and of another 20 until the end of December 2001.

According to APAPS, 259 enterprises were privatized in 2002 (in 112 of them the state held a majority package), 35 of which were large and extremely large companies.[27] This led to a reduction in losses in 2002 by USD 55.5 million and in unpaid bills by USD 623 million. Now, after almost 13 years of transition, private share capital has reached over half of the total share capital in Romania, that is 54.84%. Some 60% of the increase is owed to the activities of the Privatization Authority, while the remaining 40% resulted from the development of the private sector. Presently, APAPS holds 8.47% of the total

[21] Interview with Graeme Justice, May 9th 2003.
[22] *Capital* magazine, no.12, March 20th 2003, www.capital.ro.
[23] Interview with Graeme Justice, May 9th 2003.
[24] Interview with Adriana Tran (APAPS, The Department of Communication), May 17th 2003.
[25] Interview with Adriana Tran, May 17th 2003. EBRD and IFC will hold 25%; the five Romanian Societies for Financial Investment (SIF) will hold 30%; employees will hold 8%. It is questionable whether EBRD and IFC shareholdings can be considered private.
[26] Interview with Graeme Justice, May 9th 2003.
[27] Interview with Adriana Tran, May 17th 2003.

state interests (of which 6.41% are majority packages), compared to 12% at the end of 2001.[28]

The evolution of the number of enterprises and companies in which APAPS held a majority package over the period 1996-2002 is shown in the following graph:[29]




The graph shows that the number of companies in which APAPS held a majority package decreased significantly from 4,510 companies (in 1996) to 392 companies (in 2002). Now APAPS owns "almost 70 companies that are big and very big, which represent 97-98% of the total share capital which will be privatized."[30] APAPS's main objective for 2003 is the finalization of the privatization of the companies owned by it in accordance with the tasks assumed in the negotiations with the World Bank and IMF, as also necessitated by the perspective of Romania's accession to the EU.[31]

In spite of the optimistic pronouncements of Romanian officials, financial experts dispatched by the IMF believe that "the privatization process has made very slow progress because of the Romanian authorities' practice of conditioning privatization on the buyer's promise to maintain the number of employees and make certain investments."[32] According to a technical memorandum additional to the current stand-by agreement, the revenue that Romania must derive from privatization must amount to ROL 1,000 billion in each quarter of 2003, that is, ROL 4,000 billion (some 120 million USD) for the entire year,[33] which is not so easy to accomplish if we think of the level of attractiveness of the Romanian state-owned enterprises to investors.

On the other hand, APAPS has developed two methods for the finalization of the process of privatization: "blitz-privatization" and "Euro-privatization" (privatization for

[28] National Television, tvr.ro, January 6th 2003, 08:27.
[29] See the website of APAPS and specifically the webpage http://www.apaps.ro/rapoarte/Privatizare.pdf. The graph provided here is based on data taken from the APAPS graph entitled "Situatia numarului de societati la care APAPS este actionar majoritar."
[30] Interview with Adriana Tran, May 17th 2003.
[31] Interview with Adriana Tran, May 17th 2003.
[32] National Television, tvr.ro, May 9th 2003, 09:30.
[33] National Television, tvr.ro, May 9th 2003, 09:30.

the price of 1 Euro).[34] "Blitz-privatization" implies the acceleration of the process of privatization negotiations: almost daily meetings between the negotiating partners and an agreement to honor the deadlines (associated with consequences for not honoring them; for example, absence at two successive meetings leads to the exclusion of the investor from the process of privatization).

"Euro-privatization" is regulated by Government Ordinances 208/2002 and 8/2003.[35] The main objective of this method of privatization is the transformation of the income which should result from privatization into investments into the company. "Euro-privatization" is to be achieved through Government Ordinances for companies which are judged unattractive. The criteria for the selection of these companies are: the status of the company (whether it has been through an unsuccessful privatization attempt, for example), the area of the company's activity, the unemployment rate in the region, and the economic status of the region.

Ovidiu Musetescu, Minister of the Privatization Authority and State Participation Administration, is confident regarding the privatization of the remainder of state-owned companies until the end of 2003: "We can privatize them. All the calculations show that, all in all, we can finish the privatization. If there will be four or five companies which won't be privatized, this won't be such a dramatic thing."[36] The fact that private share capital has reached over half of the total share capital in Romania proves that Romania has indeed taken important steps towards the privatization of the state-owned companies. However, it is also true that none of the stand-by agreements between Romania and the IMF have been completed to date, and that this is largely a result of the slow and problem-fraught process of privatization. The reasons for the lack of success in this area are connected to the unattractiveness for the investors of the companies involved (huge arrears, a high number of employees, low productivity). Also, the Romanian business environment is infamous: prohibitive levels of bureaucracy, corruption, an unstable fiscal and legal environment, and high social expenditures discourage potential investors.[37]

Other privatization cases were unsuccessful because the conditions agreed upon by the Romanian state and the investors remained unfulfilled. The most representative case of this kind is that of the steel company CSR (Combinatul Siderurgic Resita). The privatization contract between the Romanian state and the investor - Noble Ventures Company (NVC) - was canceled in January 2003 because NVC did not honor the conditions stipulated in the contract. NBC had bought 94.4% of CSR's share capital, the value of the transaction being estimated at USD 85.25 million.[38] In April 2002, the General Association of CSR's Shareholders decided on the transformation of CSR's unpaid debts into share capital (the value was about USD 65 million), to be assumed by the creditors. Thus the state became again the principal shareholder of the company, with 85% of holdings. NVC should have bought these shares until the 31st of December 2002 but did not, and the privatization contract was thus cancelled. APAPS hired the audit firm Pricewaterhouse Coopers to draft a financial report regarding the consequences of CSR's

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[34] Interview with Adriana Tran, May 17th 2003.
[35] Interview with Adriana Tran, May 17th 2003.
[36] Interview with Ovidiu Musetescu, conducted by Reuters Agency, April 14th 2003, www.apaps.ro.
[37] Interview with Stephane Cosse, former IMF Resident Representative in Romania, conducted by *Evenimentul Zilei*, January 11th 2003, www.fmi.ro.
[38] *Ziarul Financiar*, April, 9th 2003.

handling by Noble Ventures. This paper will be used in the trial opened by NVC against the Romanian State before a Washington-based court of arbitration.[39] Production at CSR was restarted in March 2003, after two years of administration by the American company.

It is not easy to decide who and what is to blame for this failure -- the Romanian state for signing a privatization contract without knowing very much about NVC, the Romanian fiscal and legal system which made the accomplishment of the stipulated conditions by NVC impossible, or the lack of business ethics of NVC -- but one thing is certain: The CSR case was an unsuccessful case of privatization which blocked the company's activity for almost two years and caused serious harm to its employees.

Returning in conclusion to the questions raised above, we may say, first, that privatization in Romania is pushed forward more by the World Bank than by the IMF (as can be seen in the stand-by agreements, which specifically subsume the IMF's concerns under the privatization programs established with the World Bank). As Graeme Justice confirms, the IMF's role in this policy area is to "back up" the strategy and the priorities laid out in these programs. However, since the IMF is interested in the evolution of macroeconomic indicators, it must of course be interested in the process of privatization as well. As Justice has put it, "For macroeconomic reform to be stable you need to get rid of the state-owed enterprises."[40] Moreover, privatization appears to be a higher priority for the IMF than for the Romanian state, since it is now seen as the second most serious point of divergence between governmental policy and IMF conditionality (after the issue of wage policy).[41]

All memoranda include some specific or less specific references to the criterion of accelerated privatization. What can be said for sure is that the number of state-owed companies has decreased substantially since 1989 but also that progress has generally not been fast and sweeping enough for the IMF officials. On the one hand, the importance of the IMF in the privatization process can not be denied, but, on the other hand, we cannot quantify this importance: The IMF has generally been relevant in helping to push through privatization, not in developing strategy, except for the banking sector where it has some special expertise.[42]

Concerning the reasons behind the policy objective of privatization and why privatization is important for the IMF, it is clear that the privatization of the state-owned companies affects the main interest of the IMF: macroeconomic stability. Reduced participation of the state in the management of economic actors and relations between them is, according to liberal economic theory, expected to have a positive influence on the general functioning of the market economy. A privatized economic environment, through the operation of competition, encourages the maximization of efficiency (stimulating GDP) and financial discipline. Combined with proper regulation and enforcement, such an environment is also expected to eliminate the problem of arrears and relieve the pressure exerted by non-competitive or undisciplined economic actors on the state budget.

[39] *Evenimentul Zilei*, April 2nd 2003.
[40] Interview with Graeme Justice, May 9th 2003.
[41] Interview with Graeme Justice, May 9th 2003.
[42] Interview with Graeme Justice, May 9th 2003.

If the IMF had not been involved in Romania, the external push to privatize would have come mainly just from the EU and the World Bank. This would probably have meant an even slower process of privatization. Over the last 13 years, the memoranda signed with the IMF included more and more specific criteria related to privatization, which were sometimes respected by Romanian authorities, and sometimes not. The reasons for including more and more specific criteria include the desire of IMF officials to see some concrete cases of privatization successfully pushed through, to signal progress and lend momentum to the overall process. Sometimes these concrete attempts were successful. The question is: Would the influence of the World Bank, the EU, and other factors operating have been enough to lead to the successful privatization of those companies? Probably in the end those companies would have been privatized anyway. But privatization might have taken longer, with potentially negative consequences for the Romanian economy. In the context of the last 13 years in Romania, generally speaking, the more the state has delayed the privatization of a company, and the more difficulties and obstacles the process has involved, the lower the interest of attractive investors in buying that company has become and the more the chances for successful (lucrative) privatization have diminished (unless other factors have intervened to increase interest in a given sector). Up to now, with respect to the issue of privatization, the IMF has played the potentially crucial role of supporting the acceleration of the process.

**4. Arrears**

There seems to be a direct effect of the difficulties in assessing the real impact of the IMF's programs in Romania on the criticism this organization receives in Romanian public opinion. This section tries to contribute to solving this problem by continuing the analysis of the conditionalities that accompany the stand-by agreements and the policies of the Romanian government which respond to them. As mentioned above, the overall impact of the IMF is difficult to evaluate, as it is not the only international organization working closely with the Romanian government for similar objectives. Two others are of vital importance. One is the EU, which clearly shapes all policies since integration represents the mythical "end" of the transition period in Romania.[43] The other is the World Bank, whose programs differ in scope from those of the IMF but whose work is complementary, as conditionalities largely overlap.[44]

The impact of IMF policies has come under more scrutiny, not only from outside but also from the inside of the organization, as it has stayed in Romania longer than it intended (running six programs within a decade). It has gone well beyond its initial minimalist purpose: to help initiate a corrective macroeconomic policy to respond to a crisis in the balance of payments. The prolonging of the IMF presence in certain countries (due mainly to non-compliance and repeated breakdown of the agreements) and the quest to find the right tools to implement the needed corrective measures have led to

[43] The EU treats the fulfillment of obligations concerning IMF and World Bank programs as conditions for progress in the accession negotiations.

[44] Interview with Graeme Justice, May 9th 2003.

the development of the so-called "mission creep,"[45] in which the initial programs, concerned mainly with the stabilization of macroeconomic indicators - inflation, central bank assets, budget deficit, balance of payments – evolve to progressively include microeconomic policies (as levers for macroeconomic stabilization). This has happened also in Romania, as the IMF, in its quest for macroeconomic stabilization, has been pushed (or pushed itself) to pursue “micro” policies that were not part of its original "recipe". In turn, this process has given rise to even more critical questions about how far the IMF can legitimately go in micro-managing debtor economies.

One of the problems that threaten macroeconomic stability are arrears, inter-company and budgetary ones -- one of the specific legacies of an inefficient centralized command economy and its economically unsound (re-)allocation of limited resources. In the planned economy, many companies not only failed to make any profit, but many “consumed” more resources during the production process than their revenues could cover. They became resource-consuming instead of profit-making -- the so called "black holes" in the economy. During the communist period, this problem was not publicly visible, not only because of the state’s monopoly hold on information but also because the government, being the only owner and its own book keeper, managed to hide losses by continually relocating them. The problem of arrears persisted after the 1989 Revolution, since the subsequent governments, primarily for fear of social unrest and in some cases out of reluctance to lose sources of public (in some cases perhaps also private) income, opposed the privatization or liquidation of arrears-accumulating companies. In time, the problem has grown and become more visible, to the point of now being one of the biggest threats to macroeconomic stabilization. Essentially because of slack enforcement of financial discipline, companies have accumulated debts towards any combination of the following three: the state budget, banks (for contracted loans), or companies (for supplied goods).

Arrears are defined in Government Ordinance 79/2001 as overdue payments mentioned explicitly in contracts or, if there is none, remaining due 30 days after the delivery of the services or products in question. Reporting of arrears has to make reference to the following categories: arrears towards the state budget, towards the social security budget, towards the local budget, towards the special funds budget, or towards other creditors. Arrears towards the consolidated general budget are defined as the sum of the first four categories.[46]

Our aims in this research are both descriptive and analytical. This leads us to search not only for the rationales behind the IMF's policy guidelines but also for the relationship between these guidelines and the reactions of the Romanian governments to them. The data used to assess IMF arrears policy has been obtained from an extensive search of all memoranda, while the responses of the Romanian governments were monitored through an analysis of all ensuing steps, ranging from the supplementary

[45] Interview with Graeme Justice, May 9th 2003. Tony Killick links the "deepening" of IMF programs with the increasing number of breakdowns of agreements. See Tony Killick, *IMF Programs in Developing Countries: Design and Impact* (London: Routledge, 1995), p. 35.
[46] See *Monitorul Oficial*, no. 748, November 23rd 2001, Government Ordinance no. 79/2001.

memoranda on economic policies subsequent to the stand-by agreements[47] to legislative measures, and including an overall policy analysis.

Not being an "initial IMF policy"[48] but included in conditionality due to "mission creep,"[49] the arrears problem slowly but steadily worked its way up the IMF agenda and into the memoranda, because of the genuine threat to macroeconomic stability it posed. Arrears are mentioned in the 1992 memorandum only in passing, without being raised to the status of performance criterion.[50] The dynamics of the arrears problem have since proven to be quite complex. As explained above, arrears can be accumulated to three types of creditors: to the state - through the budget; to banks - through failure to service and/or repay contracted loans and credits; and to companies that have provided services and/or goods. Although these are in theory three types of creditors, in reality there are only two, since within the banking system the state has remained the guarantor of contracted loans "at the end of the line." Through an intricate system of decision making which basically followed considerations of political interest, and due to the irrationality of a system in which the state itself was the major shareholder in the companies with debt to itself, companies found it quite easy to contract loans and credits from banks and never re-pay, in order to cover the payments for other creditors, namely other companies. This is how, throughout the 1990s, the banking system was used as an exhaust pipe for arrears. Vital to the scheme was that there always had to be someone at the end of the line to pick up the bill. During all this time, this was the state (or, better said, those parts of the state budget not protected by the most powerful elites) and thus of course the population at large, which, after the cycle eroded and the banks started collapsing, saw their savings swallowed instantly by the black holes in the economy. This model is confirmed by the 1994 memorandum, in which performance criteria were aimed only at the banking sector, by either limiting the transfer of company debts to banks to the general consolidated budget or limiting the issuance of governmental guarantees for bank loans to companies, and not at the budget or companies directly.

As early as the 1994 memorandum, the policies officially adopted by the government in order to solve the arrears problem comprised virtually all possible measures to reduce them, the first of which was privatization. Thus, if only in rhetoric, the government shared the IMF's opinion that the best way to reduce macroeconomic instability was to privatize all state-owned companies, especially the loss-making ones. The point of contention between them was not the policy itself but the pace of implementation or the methods used. The government chose to actively involve itself in the restructuring of large companies with large amounts of debts. In its bid to contain the problem as fast as possible, the government isolated 30 heavily indebted companies from access to the banking system and placed them under the surveillance of a "restructuring committee" composed of representatives of the Ministry of Finance, Ministry of Industries, BNR, and FPS.[51] Besides not having the desired effect (only three companies started dissolution procedures), this measure only served to make other companies more

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[47] Data regarding the supplementary memoranda on economic policies was available only for the last two agreements included in this research.
[48] Interview with Graeme Justice, May 9th 2003.
[49] Interview with Graeme Justice, May 9th 2003.
[50] See *Monitorul Oficial*, no. 161, July 14th 1992, Law 64 (8th July 1992).
[51] Government Ordinance 61/ August 24th 1994, *Monitorul Oficial*, no. 247, August 1994.

dependent on the state to bail them out. Another policy proposed by the government and approved by the IMF was to impose more severe penalties (up to 0.4% of the owed sum) in order to increase financial discipline. Again, this ended up having the effect of actually discouraging financial discipline, since the inability to pay an ever-growing debt created a psychological tendency towards embracing non-compliance whole-heartedly. Another policy suggested, and perhaps one of the most important, but not agreed to by the government, was a bankruptcy law to regulate the criteria for entry and exit from the market in a transparent and non-discriminatory manner.

The presence of arrears in the Romanian economy represents a gross violation of the basic law of a market economy: Payment contracts (over services and goods) must be honored in due time; otherwise payment incapacity must be officially determined, and bankruptcy procedures initiated. The existence of companies that have been able to avoid such proceedings for 13 years shows the unwillingness of all post-1989 Romanian governments to address this issue in a drastic manner. In addition, it signals the need for deep structural reforms, as the solutions to such a problem do not reside in adjustment. Yet again the IMF faced internal debate over not only for how long it should be involved in a country with such a low level of compliance but to what extent should it be involved in structural reform policies rather than stabilizing ones, as the former consume more time, human and financial resources and are more commonly considered the prerogative of domestic decisionmakers.[52]

A vicious cycle, sustaining losses by keeping them motion between companies, banks, the state budget, and the population, came abruptly to an end with a domino of bankruptcies in the banking system. International organizations now intervened to prevent serious destabilization by putting their weight behind drastic measures to limit bank credits to companies; from 1994 onward they were never to exceed 1,5% of GNP.[53] Deprived of an exhaust pipe, the companies had no choice but to redirect their arrears towards their suppliers, accumulating inter-company arrears. The most convenient way was to accumulate arrears to the utility companies, which (being declared *regies autonomes*) the state had no interest in privatizing and which enjoyed privileged relations with it.[54] The model is again confirmed by the inclusion of performance criteria for reducing arrears to the three biggest utility companies, CONEL, ROMGAZ and Petrom, in the 1999 agreement and to their inheritors (after the restructuring of CONEL and ROMGAZ) in the 2001 agreement.

In 2000, two companies, CONEL and ROMGAZ, underwent a restructuring process resulting in their breaking up into several smaller companies. CONEL became Termoelectrica, Transelectrica, Electrica and Hidroelectrica. Two of these, Termoelectrica and Electrica (especially Termoelectrica), adopted most of the arrears of the former company. ROMGAZ became Transgaz, Exprogaz, Depogaz, District Sud and District Nord.[55] Among them, the last two became the biggest debtors, as they did not only adopt the most outstanding payments but were also (as well as Termoelectrica and Electrica) in debt to the state budget. The break-up of the two companies into smaller ones did not yield the desired results in terms of reducing arrears to fulfill the

[52] Interview with Graeme Justice, May 9th 2003.
[53] Government Ordinance 61/ August 24th 1994, *Monitorul Oficial*, no. 247, August 1994.
[54] A "regie autonome" is a state-owned company that is not allowed to make profit.
[55] *Evenimentul Zilei* Online, September 15th 2001, http://www.expres.ro/.

performance criteria. In fact no agreement has ever contained a successful policy to reduce the arrears, meaning that no government could comply with the performance criteria established in the memoranda. In the 1999 agreement (end of May), the estimated arrears of CONEL, ROMGAZ and Petrom to the consolidated budget amounted to ROL 6,359 billion. The commitment of the Romanian Government to reduce the arrears (performance criteria) was to be realized by a gradual reduction of arrears by no less than ROL 300 billion by the 31st of July 1999, by no less than 1,200 billion by the 31st of October, and by no less than 2,000 billion by the 31st of December 1999.[56]

This first memorandum was followed by a supplementary one published in May 2000 to assess the performance within the agreement. It showed that no performance criteria had been met. The cumulated arrears should have been reduced by December 1999 to at most ROL 4,359 billion. Not only were they not reduced, but the overall arrears of the three main utility companies, which had added up to ROL 9,057 billion in December 1998,[57] had increased by another 1,400 billion (reaching 10,445 billion) by March 2000. This was all the more frustrating since this memorandum was the first one to adopt a hard-line policy regarding recovery of the arrears by committing the state to forced execution in order to collect due payments.

The internal arrears of the three utility companies (that is payments that had to be recuperated from clients) was estimated on February 28th 1999 at ROL 10,607 billion overall - out of which CONEL was owed 4,116 billion, Romgas 2,245 and Petrom 4,048 billion. The performance criteria for these arrears were also set very high, indicating zero tolerance, meaning that the state committed itself to keeping the figures stable for the remainder of the year. However, performance criteria for this type of arrears had also been violated by December 1999. By the 31st of December 1999 they had risen to ROL 15,708 billion, out of which CONEL was owed 6,557 billion, ROMGAZ 3,359 billion, and Petrom 5,800 billion.

In the 2001 Agreement, the new government changed tactics in dealing with inter-company arrears for Distrigaz Sud, Distrigaz Nord, Termoelectrica and Electrica. Instead of setting up maximum ceilings for the accumulation of arrears, the government took a seemingly more pro-active approach by setting up minimum levels of collecting payments (as a ratio between received and invoiced sums). However, this new approach had little effect on compliance, as the performance criterion for the 31st of March 2001, a rate of recovering payments of 97.5%, was not achieved. In addition, another major problem was represented by the arrears of the four companies to the state budget, especially those of Termoelectrica, which was in danger of becoming insolvent and whose debts to the state budget alone amounted to a third of total.[58]

As we can see, both programs have resulted in an inability to deliver on the performance criteria set up in the memoranda, not only regarding arrears but also fiscal policy more generally, including salary policy and a timetable for utilities price increases. Still, the last agreement, signed on the 31st of October 2001, is the first post-1989

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[56] Government Ordinance no. 76/ 30th August 1999, on the approval of the stand-by agreement; *Monitorul Oficial*, no. 422, August 31st 1999.

[57] *Monitorul Oficial*, no. 422, Government Ordinance no 76 72/08/1999.

[58] According to *Adevarul* Online, November 30th 2001, www.adevarulonline.ro, the arrears of Termoelectrica to the state budget amounted to 1% of the GDP. But the figure seems too low, given that the total of arrears is about 25% of GDP and Termoelectrica's debts to the budget are about a third of all debts.

agreement that still might be completed. The difference between the last agreement and the previous one is that macroeconomic indicators have clearly improved over the span of the agreement. Inflation has been brought down, GDP growth has remained notable for several years, and budget deficit increases were contained. This represented a level of progress with respect to macroeconomic criteria that no other stand-by agreement has witnessed. This raises the question of how much progress in deep structural reforms has mattered in the decision to continue the current agreement, compared to arguably more shallow signs of macroeconomic recovery.[59]

Being based on negotiated agreement, we can consider cooperation between the IMF and the Romanian Government as taking place between two rational actors trying to maximize their own ends. Following this model, the Romanian government proposes the least tightly conditioned agreement still “tough” enough to get accepted,[60] while the Fund pushes through a set of conditions without which it deems the assumption of the risks of the agreement unjustified. Current debate (within the IMF as well) concerns the question whether core conditionalities have shifted or need to be shifted towards more complex structural reforms potentially involving mission creep into micro-management. If so, divergence from structural performance criteria would be more likely to lead to a breakdown of the agreement. So far, non-compliance is tolerated to the extent that it does not jeopardize the IMF’s constitutive norms. This method generates a bargaining space in which both actors can move without jeopardizing the integrity of the framework for cooperation. It is thus problematic to criticize governments for unwillingness or inability to stick tightly to initial promises, since arrangements are understood from the start to include the possibility of straying (to some extent).

It is, however, clear that the persistence of the arrears problem in Romania has impeded economic reform more generally, as it has undermined the main structural reform component pursued (at least in the long run) by both the Government and the IMF: privatization. The delay of restructuring and privatization has led to the accumulation of such high arrears that it has now become very difficult to save and/or sell the affected companies, prolonging the agony of restructuring even further. Using the threat of bankruptcy to push for restructuring (viable even in other transition economies) was non-viable in Romania, where the state remained both unreformed debtor and lenient lender for many years. It is an indictment of the market economy status of Romania that the only real pressure so solve the problem came from the international “nannies” and not from within, through the operation of market forces. It is also a testimony to the high level of politicization of economic policymaking in the country, the government taking a paternalistic and protectionist approach to dealing with arrears. The solution adopted by the government, besides allowing companies to get away with it, was to develop, in response to the criticisms of the international and business communities, a policy of containment through which 86 companies (53 enterprises and 33 regies autonomes) were "isolated" from the system and closely monitored.[61] A study published in 1999[62] showed

[59] The Romanian media have depicted conflict in the relations with the IMF as being primarily over structural matters (like privatization).

[60] Of course it is also possible for a government to voluntarily embrace harsher conditions, most likely in an attempt to gain backing against domestic opposition.

[61] Emergency Ordinance no 147/ November 9th 2001, on the signing of the stand-by agreement, in *Monitorul Oficial*, no. 748, November 11th 2001.

[62] Arabela Sena Negulescu, "Intreprinderi vechi si restructurate," CEROPE working papers, October 1999,

that this type of policy brought no improvements in performance, as it encouraged neither privatization nor restructuring or bankruptcy. Even more, the budgetary constraints were less tight in this group than those other companies had to face, because of access to special funds and subsidies. By the time the study was published, the monitored firms "kept a larger number of employees, had become less productive and had received larger amounts of budgetary transfer."[63]

Even the laws regarding the recovery of arrears to the main utility companies (water and energy) are merely a detailed plan for re-phasing arrears. Emergency Ordinance no 57/2002 reads: "At the request of the debtors … the creditors will grant, on a case by case basis, … phasing of payment representing two years' invoice value."[64] The plan contains criteria for economic and disciplinary performance by which the company is rated for every aspect of the arrears situation (like duration, ratio of arrears to turnover, age of the company, etc.). The maximum score is 168 while the minimum to qualify for the program is 30. The more companies pay, the more exemptions they qualify for. The emergency ordinance regarding the recovery of budgetary arrears of the same year is even more relaxed, as it lowers the minimum score for applying for exemption from 30 points to 14 points.[65]

The government seems to continue to choose the lowest common denominator acceptable to two opposing forces. On the one side, it has to deal with the push for restructuring and privatization and essentially neoliberal economic policies advocated not only by the IMF but also by the World Bank and EU. On the other side, it needs to respond to domestic pressure and strong public opposition to IMF policies, as the employment situation and standard of living of much of the population have deteriorated throughout the term of the IMF agreements. One way out of this dilemma might be a "marketing" of the IMF's image and policies to the Romanian public. Economic reform in Romania has always been elite driven and has never comprised a broad public consensus. The government itself, by employing impersonal external forces, such as the IMF, as scapegoats for unpopular economic policies rather than explaining them to the public, has unfortunately fueled this process. It might be considered whether the government should not instead try to build a public consensus to support its policies.

An important question for our research project is whether the model proposed and described here for the relationship between Romanian and the IMF in the area of arrears corresponds to the overall relationship or constitutes an anomaly. Looking at cooperation in other policy areas, such as privatization and wage policy, supports the validity of the model. Although the IMF has imposed certain strict conditions in this area, it has in its reviews focused mainly on macroeconomic indicators and aggregate figures, thus leaving a free hand to the government as regards policy implementation. As a result, the IMF's overall impact on Romania's economic and social policy is once again difficult to assess. One vital success of IMF involvement has been to help force the Romanian government to address structural reform problems, such as arrears, that otherwise would likely not

www.cerope.ro.

[63] Arabela Sena Negulescu, "Intreprinderi vechi si restructurate," CEROPE working papers, October 1999, www.cerope.ro.

[64] Government Ordinance no. 57, regarding recovery of arrears of main utility companies, in *Monitorul Oficial*, no. 351, May 27th 2002.

[65] Emergency Ordinance regarding recovery of budgetary arrears, *Monitorul Oficial*, no. 233, May 8th 2002.

have been addressed. Even as reforms in this area to date have been only partial and not very successful, it can still be argued that the IMF's presence in Romanian has been beneficial in this regard.[66] Even when employing imperfect means and relying on motivations inconsistent with the value system promoted, following a "logic of consequentiality" rather than a "logic of appropriateness,"[67] IMF norms and standards, infused into Romanian domestic politics, have led to the advancement of reform. Moreover, repeated use of the logic of consequentiality as well as the prolonged presence of international organizations in Romania have had the effect of creating of a logic of appropriateness as well, as governments have increasingly seemed to view reform as positive in itself and not merely as an unavoidable response to structural constraints and international sticks and carrots.

**5. Wage Policy**

In the 1992 agreement, the Romanian government saw wage policy as an instrument suited for two main purposes: one was to limit the direct effects of wages on inflation and other macroeconomic indicators; the second was to reduce production costs in enterprises and so to reduce budget expenditure and improve the ability of these enterprises to pay their creditors and suppliers and their debts to the state budget.

Inflation and its causes are a controversial subject in economics. Romania's agreements with the IMF suggest a relationship between wages and inflation as sketched below. An increase in the general level of prices was a necessity during the Romanian transition, as prices were kept artificially low in the planned economy. The problem of determining prices, however, did not become any simpler after 1989, as most means of production remained state-owned throughout the period to follow. The adjustment of prices to a competitive level was even more complicated, as all post-89 governments have had to deal with companies in which the costs of production outpaced revenues (the loss-making enterprises).

A suggested way to deal with inflation in the short run[68] (until an economy can supply desired commodities at manageable costs) has been to keep demand to the level of supply. Increasing demand not sustained by a similar level of increasing supply is the typical recipe for inflation. In Romania, the productivity of labor has continuously decreased while wages have increased during the period in question. Increasing demand combined with decreasing output endangered the trade balance as well, as consumers (firms and households alike) covered the difference through imports. Many of the loss-making companies have also been supported through inflationary subsidies and bank credits, and their lack of financial discipline contributed further to inflation, as the government tried to make up for the losses incurred to the budget, banks and suppliers.

In the long run, the solution was, of course, for the state to get rid of the sources of these losses (preferably by privatization, in order to keep production going and employment as high as possible in the short run). In every agreement with the IMF there are provisions for structural reform, but the effects of these reforms, inasmuch as they

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[66] Interview with Graeme Justice, May 9th 2003.

[67] See Ronald Linden (ed.), *Norms and Nannies: The Impact of International Organizations on the Central and East European States* (Lanham, Md: Rowman & Littlefield, 2002).

[68] These considerations and the following reflect the rationale behind the policies supported by the IMF as suggested in our interview with Graeme Justice and in the memoranda.

have been carried out, will take more time to show. Thus, in the short run, wage policy was identified as a lever to control inflation through controlling expenditure. Wages were a problem at the enterprise level for the profitability of the enterprise, as they accounted for most of the production costs. Moreover, if the enterprise was kept operating inefficiently, this also meant an exceeding demand for goods and services created by its unproductive workers, thus enhancing inflation.

Wages were the obvious short-term solution because other costs were impossible to reduce (except when the enterprise itself reduced its output, which had undesirable effects on employment). The costs of imported production goods could not be avoided, and the costs of domestic production goods, especially those bought from other state-owned companies, were themselves increasing to cover for the costs of the loss-making companies. As prices rose and living standards fell, taking into account the political power of the unions and the fact that employees who were subject to wage cuts were also voters, the wage problem could prove to be a trap.

The IMF pushed from the very beginning for significant cuts in costs as a way to improve macroeconomic stability. Labor costs appeared as a significant factor from the first memorandum to the last. We have been interested in finding out how influential the conditions of IMF agreements have been in this area throughout this time. Since the very nature of these conditions has changed over time, it is also important to consider the significance of these changes.

One way to answer our question would be to study the evolution displayed in the agreements. Yet these agreements cannot show conclusively whether the conditions were transformed into actual policies. Wage cuts might have never disappeared altogether from the agreements because they were always a short-term solution. They may have been seen as the most accessible way to deal with macroeconomic problems, but might not have been a means to ensure the stability of those indicators. Alternatively, the reoccurrence of the conditions could be interpreted to show that earlier attempts to implement wage reductions were unsuccessful. Besides the texts of the actual memoranda, we have thus used other official data, such as laws, emergency ordinances, and governmental decisions published in *Monitorul Oficial.* We have also used press coverage, where available, to check whether policies have actually been implemented.

As shown by the 1992 agreement, wages were not a pressing issue at that moment, as many prices were not yet liberalized, inflation being thus still controlled. Nevertheless, they appeared as an indicator of the financial performance of the state-owned enterprises and as an important problem for macroeconomic stability and economic performance in the near future. The main problem was seen to be the financial discipline of the loss-making enterprises. Among the proposals of the government on the matter of reducing these losses there was one that invested administrative and judicial responsibility for the financial performance of the state-owned enterprises (they were the vast majority at that time) in the management boards of these enterprises (§ 9).[69] The government saw the wage issue as a possible future problem as prices were due to increase. As the main employer in the economy was the state, the increase in wages was to be controlled "in the long run," to keep the rate of wage increase below the rate of inflation.

[69] Paragraph numbers refer to the relevant passage in the stand-by agreement discussed.

At the enterprise level, a ceiling was to be set for wage expenditure, dependent on the economic performance of each enterprise. The punishment for those enterprises where the costs due to wages would exceed the ceiling was to be a "penalty tax" that could reach up to 500% of the regular taxes. It appears impossible to find out where such a tax was applied and with what consequences to those enterprises that were subjected to it; but it is reasonable to assume that the continued operation and financial decline of the problem enterprises is proof that it was never applied on a large scale. The purpose of the tax was in any case never achieved.

From the very beginning, wage-limitations went hand in hand with a more "structural reform-oriented" policy, namely cuts of "excess labor". That is another reason why the limits set for wages were not conceived in terms of individual wage limits, but in terms of the total labor costs at the enterprise level.

In the agreement concluded in 1994 the wage problem comes up again, as the need to stop the inflation rate increase is now in the fore. Constraints on wages are seen as another means directed to that end and are implicitly included in the promise of "severe budgetary restrictions" to be applied to state-owned enterprises (§ 3). A law was promised to limit the wage expenditure in the public sector as well as in the state-owned enterprises; the rate of increase in wages here was set to follow the same course, below the rate of inflation (this was termed "partial compensation" - § 56).

Another, competitive, objective was, however, to allow a moderate increase of wage expenditure in the public sector, as the emerging state agencies needed to expand and employ a growing number of people (§ 12). To limit wage expenditure in the public sector to rise no faster than inflation while allowing for such expansion was particularly difficult. This is why limits to increases in wages were not set explicitly; there are only ceilings for the overall budget expenditure.

In the 1994 agreement, the government tended to resort more to general rules in order to enforce financial discipline, such as the bankruptcy law, or penalties, rather than to limit the autonomy of the management (one has to bear in mind that the "management contract" was still seen as a good way to ensure the efficiency of the state-owned companies) (§ 49 and 50). Nevertheless, the government professed to be ready to impose lay-offs wherever labor was in "excess" (§ 56).

The 1997 agreement provided a different environment for wage policy. This agreement was dominated by daring targets regarding inflation, which had turned out to be a major problem in the government's attempts at macroeconomic stabilization, and also by a more radical government program to restructure the state-owned sector of the economy.

One important problem that the new government faced after the 1996 general elections was the necessity to adjust the controlled prices so as to cover the costs of production. Together with the liberalization of exchange rates, the immediate and foreseen consequence of this measure was upward pressure on inflation. This situation transformed the wage policy of the government into an important instrument to counteract this pressure.

Thus the concern that wages had increased more than the productivity of labor could justify appeared for the first time in a memorandum. This shift could be explained also by the electoral turnover, which enabled the new government to expose structural economic problems, justifiably or not, as a result of the economic policies of the former government. Now explicit rules were set up for wage increases in the loss-making state-owned enterprises and in public administration, such that the increase in 1997 could not be more than 75% of the anticipated inflation rate (§ 31). This time it was not the total wage expenditure at enterprise level that was subject to limitations (as was the case in the former agreement), but the mean wage, which could be a sign of the inefficiency of the former, enterprise-based, method of limiting wage increases. The aim was to obtain a reduction of the real average wage of 6% in 1997.

It is important to note a double shift in the approach brought about by this memorandum. On the one hand, the problem of wages was now seen as a general problem, not only a problem of the state-owned loss-making enterprises, due to its link with the aim of reducing inflation. On the other hand, the problem of wages is conceptualized as coming logically after other "structural" problems, such as arrears and, most importantly, privatization. Production costs were to be reduced primarily through privatizing or closing down the most important loss-making enterprises in the short run (§ 42). Also, in the public sector there were scheduled lay-offs that went so far as to include 5% of the number of existing employees.[70]

For the companies where privatization or total shut down were not viable options (all the regies autonomes and mining companies mainly), individual restructuring plans were drawn up, designed to reduce costs, including labor costs, through lay-offs as well as cuts in wages (§ 43). Traditionally, these important companies were well-known for the comparatively large wages their employees received. The miners had also long enjoyed a special status in the matter of wages as well as subsidies.

The 1999 agreement acknowledged wage policy as one of the main tools in the macroeconomic program of the government. This tool is explicitly used for the purpose of cutting down inflation, both through an increase in the monetary mass and through controlling consumption, as well as for the improvement of productivity in the short run (§ 9). This restrictive wage policy towards goes once more hand in hand with the reduction of costs through privatization and restructuring of the loss-making companies. The target set in this agreement does not differ from the already existing ones: the increase in wages is to remain "much below" the rate of inflation.

The government also agreed not to expand the program of the so-called "meal tickets" (*tichete de masa)* (§ 19), a promise which it kept. It even proved unwilling to enforce the existing law regarding meal tickets during the year 2000, despite pressure from the unions. The commitment not to enforce the law was made explicitly in the agreement concluded in 2001.

The increase of wages in the public sector was limited to a maximum of a decrease in real terms of 9% (considering the anticipated rate of inflation). That figure represented the total budgetary expenditure on wages in the public sector (§ 23). For the regies autonomes and another 24 loss-making companies, the wage expenditure was to be exceptionally contained. A ceiling was to be set for the wage fund of these companies, so that the nominal wage would increase by 16% and the real wage decrease by 18%.[71] For the first time, the limits imposed on the growth of wages were performance criteria in the agreement, which is again evidence of the previous incapacity of the Romanian

[70] That was a prime target of the government. See the Second Annex of the Agreement.
[71] The anticipated rate of inflation in 1999 was 38% (§ 10).

governments to keep the wages within the desired limits. The wage fund for these companies was to be monitored every three months by the IMF.

However, in the technical memorandum of 2000 the Romanian government acknowledged failure to comply both with the standard set for the state-owned companies (in November and December 1999) and with the one set for the public sector wages. Again, wage policy was designed to go along with lay-offs in the most important loss-making companies, especially the mining companies (which were supposed to let go 8,000 employees) (§ 31).

It is important to note the shift in the agreements between 1997 and 1999 with respect to wage policy. Wage policy was thought to be an important instrument in 1997 also, but the stress was on privatization and restructuring of the loss-making enterprises. Two years later, as the pace of the "structural reforms" proved insufficient and privatization in particular proved to be a lengthy process (as the government saw shutting down large companies as too socially costly, if not plainly impossible in the medium term – the case of most of the regies autonomes), wage policy remained one of the few instruments available to achieve macroeconomic stability in the short run.

In the technical memorandum of 2000, wage expenditure in the public sector was programmed to increase by 56% nominally, which, according to the expected rate of inflation (27% - § 10), meant an increase of 12.5% in real terms (§ 22); that increase, necessary in the eyes of the government, was to be compensated for through lay-offs (22,700 in the civil public sector – which represented 4.5% of the number of the existing employees - and another 22,000 in the military and the police).

The decrease of the overall real wage expenditure was to reach 9% in the state-owned for-profit companies and regies autonomes and 21% (through an increase in nominal wages of 10%) in the case of the largest 33 loss-making state-owned companies. Thus there were limits set for individual companies as well as a general ceiling of the wage fund in the state sector (which ensured that the nominal wage fund would increase by only 1%).

The government again resorted to a tighter policy insofar as management incentives were concerned, and again established penalties for the management (for instance wage cuts in the case of an increasing amount of arrears). Insofar as the incentives were concerned, the new policies were directed against the common "backdoor" way of increasing wages in the large companies by means of bonuses that could reach and even exceed the amount of a monthly wage.

The year 2000 was a particularly difficult year for reform, as it was an electoral year and the popularity of the governing parties was worryingly low. The government seemed to try to get the best of both worlds. For instance, on the one hand it issued an emergency ordinance (no. 58/2000) to enforce financial discipline, including the wage cuts agreed upon with the IMF. But at the same time, following negotiations with the unions, it had to give up the rule (included in the Budget Law for 2000) which said that the state-owned enterprises had to cut their wage expenditure whenever the number of employees was reduced.[72]

The overall failure of the wage policy to contain inflation is again mentioned in the 2001 agreement, which admits that internal demand has grown in real terms (calculated this time according to the real rate of inflation in 2000) by 10% (§ 3) as a

[72] *Capital*, no. 26, June 29th 2000.

consequence of the increase in wages in late 2000 and the beginning of 2001. That increase, and lax fiscal policy, were seen as the most important causes for the breakdown of the agreement with the IMF in 2000.[73]

According to data acknowledged by the IMF, the increase in nominal wages in the public sector was 52% in the first quarter of 2001, while the increase in real wages was 9%, compared to the wages in the first quarter of 2000 (that figure places the increase well above the increase in wages in the whole economy).[74] A similar increase took place in the loss-making state-owned companies.[75]

The 2001 memorandum is the first to state that the control measures already taken concerning wages in the state-owned companies were effective enough to help with the set target of inflation. The budgetary expenditure on wages in the public sector was again limited. This time, it was through an emergency ordinance that the wages were to be fixed (Emergency Ordinance no. 33/2001), a way to ensure the rigidity of wages in relation to inflation. This was possible also because the inflation target was smaller than in the previous years (22%). Again, promises were made to cut the overall expenditure in the public sector through large lay-offs (6,150 employees in 2002).

The evolution of wages in across the state-owned companies was planned to lead to an increase in the aggregate wage fund of 22% in nominal terms compared to 2001. The aggregate wages in some 86 state-owned companies (including the regies autonomes) were monitored as a performance criterion in the stand-by agreement (§ 21, 34). The order of the Finance Ministry no. 2121/2001 set up the budget for 2002 for all the state owned enterprises and includes a ceiling for the increase in wages beyond existing levels. Again, the government resorted to the same punitive measures for the management in the case of non-observance of the "performance criteria," including the ceilings for the wage funds (§ 20).

This memorandum also explicitly states that the wage policy is designed to reduce unemployment, an expected effect of cheapening labor (§ 14). It is virtually impossible to assess the success of wage policies in this respect, because changes in employment depend on many factors that have not all led in the same direction during this period of time, such as fiscal policy, the profitability of new investments, and the lay-off policy of the government in the public sector and the state-owned companies.

Wage policy went again hand in hand with lay-offs. Lay-offs were decided for the loss-making state-owned enterprises (5,213 employees in eight companies) and, as a new measure, it was decided that 3,724 employees were to be "externalized", that is jobs were to be relocated through the transfer of a part of a loss-making company to another company or its transformation into an independent one (usually newly created ones expected to fare better) (§ 21).

The number of employees (and lay-offs) in eight major companies (among which were the electricity and the mining companies) was monitored by the IMF for the first time. There was a limit of 123,439 employees to remain in these companies by the 31st of December 2001. Alongside this measure, the government also planned to forbid 75% of the state-owned companies to hire more employees. There were also 44 monitored state-

[73] See "Solicitare de încheiere a unui Acord Stand-by" of October 17th 2001, § 7.
[74] "Solicitare de încheiere a unui Acord Stand-by," § 9.
[75] "Solicitare de încheiere a unui Acord Stand-by," § 10.

owned enterprises that were forbidden to fill more than 50% of the jobs that remained vacant after retirements or ordinary transfers.[76]

In all the agreements where the wage fund is subject to monitoring, and where lay-offs were also promised in the case of the state-owned enterprises, the general purpose was to reduce the wage fund through the lay-offs. This means that the companies which externalized or sacked employees were to use the wage fund not for increases in wages or bonuses for the remaining employees, but for paying their debts. That was a particularly contentious point in negotiations with the unions. The representatives of the employees used the argument that the remaining employees took over the work load of those who left, and thus an increase in wages for those left in the company should be a normal response. The unions were further snubbed by the fact that, although the social policy of the government included a law regarding the minimum wage, this law was promised to have no influence on the labor contracts that were to be signed from 2002 onward in the state-owned companies (§ 21).

The relative importance of wage policy has depended throughout the whole period on the increases in prices of the goods and services provided by the state-owned companies. Most of the prices of these goods and services have undergone a process of liberalization (where they were not monopoly prices) and of adjustment to international price levels (a very important process, especially where production depended on imported products). An increase in the prices of their products was supposed to increase also the income of enterprises, which in turn was to enable a reduction of the ratio of labor costs to the total costs of production. However, this policy could have been effective only if the wages had not been increased during the same period of time.

The main difficulty was that the goods and services provided by the state-owned companies were important as inputs for other enterprises, state-owned or private (electricity and gas, for instance). An increase in controlled prices has an important inflationary effect, through increasing costs of production for a chain of production units, therefore making it almost impossible to keep wages at the same level as before the price increase. This points to another important aspect of the wage policy of the government. At the same time as the government was able to influence inflation and the general level of market-set prices through modifying the crucial controlled prices and the prices set by the large state-owned companies, the wages in the public sector, but especially in the state-owned sector, influenced the wages in the private sector. The state sector of the economy continued to have an important number of employees throughout the period, which means that the evolution of wages in that sector was very significant for the cost of labor in the economy more generally.

There was a clear policy shift in the last two agreements from cuts in real wages to lay-offs, both in the public sector and in the loss-making state-owned enterprises. This could be interpreted as a sign that the policy of keeping wages below the rate of inflation was less effective than desired, and more difficult to accomplish in the long run, especially given a large rate of inflation. But it can also mean that wage policy controls were meant to be a short-term solution to the problem of direct budgetary expenditure and indirect subsidies. As the negotiations with the IMF turned out to be more than an episode in the evolution of the economic and social policies of the Romanian government, the solutions offered by the policies directed towards limiting the increase in

[76] Order of the Finance Ministry no. 2121/2001.

wages became obviously less and less effective. Long-term stabilization solutions were required: It was no longer so important to keep wages down until the enterprises could manage the costs and pay their debts and until inflation would be reduced to acceptable proportions; it was more important to reduce the source of the costs through lay-offs, whenever shutting down enterprises or privatizing them was not a viable short-term solution.

The inefficiency of ad-hoc limitations on wages throughout the period is indicated also by the tendency of the government, seen after the last agreement, to resort to law-like regulations which were expected to provide a more stable and predictable evolution of the expenditures in the state-owned companies and in the public sector. This could also be interpreted as a need, seen as well by the IMF negotiators, to include strict requirements in the agreements, as opposed to accepting vague promises from the government.

There have to be two ways to assess the compliance of the Romanian government with IMF conditions in the matter of wage policy. First, there is compliance as concerns the enforcement of direct cuts in wages. Second, there is the ratio of wage expenditure to the total costs of the state-owned companies and in the public sector. The first is an indicator of immediate compliance. The second is an indicator of long-term policy-compliance, embedded within the policies directed towards restructuring; it indicates not only compliance with explicit IMF requirements but also a general trend in the government's policies to deal with the so-called "structural problems" of the economy.

This second way of assessing compliance seems to indicate that the wage problem has not been satisfactorily addressed. Wages have continued to increase and, although the number of employees has diminished, the ratio of wage expenditure to total costs has in many cases remained the same. One example are the restructuring attempts in the mining companies, which included massive lay-offs from 1997 onward. Overall wage costs in the mining companies have still not been reduced, and even increased by 1% between 1996 and 1998.[77]

The problem of "wage discipline" indeed seems to have been impossible to solve. If one looks at the specific ways in which the Romanian governments tried to solve it, one could be misled into believing that these measures bear the responsibility for the "wage discipline" issue's reoccurrence in the agreements with the Fund. But we suspect that they could in fact be no more than short-term "patches", effective only if supported by "structural" reforms. Whether important policies were adopted in this area or the governments gave way to "social pressure" did not matter in the long run (such as during the time between two agreements with the IMF). As long as structural reforms, such as privatization or liquidation, were not successfully pushed through, as long as the problems of arrears and lack of financial discipline were not tackled, the wage problem would keep coming up again, if in different places.

## 6. Financial Discipline

Intuitively, lack of financial discipline is about spending more than one has or is able to pay in due time. Whenever an economic agent is unable to pay its debt, there is necessarily another economic agent which does not get paid on time. This is the stage at which criminal law should take over the problem. This is the standard solution in a

[77] See Arabela Sena Negulescu "Intreprinderi vechi si restructurate."

system in which contracts are clear and the contractors have clear responsibilities, that is, whenever property rights are clearly defined and enforced. But these conditions are not fulfilled completely in the Romania of transition.

From a liberal economic point of view, we could equate the concept of "financial discipline" with the "rational allocation of resources in an administrative unit." The move from lack to presence of financial discipline at a macro-level can be viewed as identical to the move from a planned economy to capitalism, since capitalism is that system in which administrators (or managers) of means of production are tightly watched by (if not identical with) their owners. The problem of financial discipline is relevant to any exchange of resources between agents. The question "is this agent financially disciplined?" becomes a serious one with respect to any agent dealing with resources which are not its own. It is essentially a question about the incentives that replace the desire to maximize the utility to be derived from an economic transaction. The sphere of its relevance is large.

Liberal economic theory tells us that the best incentive for financial discipline is the private ownership of the means of production, combined with a tight monetary policy and a low and transparent level of taxation. This is the guidepost of the structural reform in Romania, as promoted by the IMF. This target could conceivably be hit following the coordinates that the IMF has indicated since 1990: lowering inflation and boosting reserve levels, decreasing the budget deficit ("undisciplined" public sector spending), reducing public sector wages, avoiding overvaluation of the leu, eliminating inter-company arrears, eliminating debts to the government, and reducing protectionist measures. It might seem that the general question, "What has been the impact of the IMF on social and economic policy in Romania?" can be answered simply: The IMF is the voice of reason; it is a father who draws up and enforces the right rules, and sometimes gives some pocket money, too. Things are, however, not quite so simple. There is no consensus that the IMF gives good advice, and even if it does it has little means to enforce its and must rely on the state for implementation.

The fact that economic transformation is achieved through political channels generates some specific problems under the heading of financial discipline. The questions addressed in this section are: Did we move from complete lack of financial discipline (a non-responsible system of property rights) towards a system based on more responsibility? Has there been a change for the better with respect to the financial discipline problem? And how strong a factor was the IMF in this process?

We will first attempt to develop theoretical responses to the questions above. We begin from the observation that the problems generating the lack of financial discipline of the state-owned companies' directors or managers have not disappeared. They are the direct result of property relations concerning capital value. Capital value is a good’s capacity to produce profit in the long term. If I own a car, for example, I will take care of it, because I want to have a good car in five years, too. If the car is not mine, all I want is to take advantage of its value now; all I own is the utility it can produce today. If I own the car, then I own its capital value. In more detail, the reasons why property matters are the following:

a) As a manager *and* owner of capital, one is interested in maximizing the sum of profit and capital value, while as a simple manager and non-owner, one is interested only in the short-term profit, during the period of one’s administration. The consequence is a lack of

care for the existing capital value, a weak level of capital investment, and, ultimately, a declining level of long-term profit.
b) On bargaining with somebody else's money: When transacting, the non-owner administrator is not bargaining his own money or his own resources. He is spending other people's money in other people's interest, as opposed to spending his own money in his own interest. Incentives for reaching the best deals are low in such cases. Worse deals are more likely to be made, and profit is thus reduced.
c) In the case of the non-owner administrator, income does not depend on the marginal utility of the administrator's work; it depends on some other rules, which are standardized. The consequences for the company's profit are not hard to guess. In this case, however, there are plenty of non-monetary advantages left to be maximized by the manager, such as personal influence (the bigger the agency I run, the higher the social status I have), two secretaries, a larger office, more vacation time, travels, training courses overseas and other semi-monetary advantages, such as a better computer, a more expensive mobile phone, more phone conversations combined with a phone bill paid by the company's funds, or opportunities from trading the old equipment.

There are things to be said not only about the managers of these companies, but about all their employees. A result of all said so far is that in a state-owned company the rules of hiring and firing are different. It is generally harder to fire anybody, since the only way to be in control, as a manager, is to reward the subordinates, with promotions, bonuses, or improvements in the size of their staff. On the other hand, the quality of being good at what he does is almost suicidal for an employee, since he depends on his superior and must not be suspected of trying to gain prestige relative to the boss's status. Moreover, since there is no intrinsic value associated with work, it must be expected that for the same amount of benefit workers will choose the least amount of work possible; and it is certainly easier to be the boss's friend than to work hard. If we are talking about a bureaucratic monopoly, then many other opportunities come to surface as well, such as taking bribes to change the order in which and quality by which the clients are served.

The logic of a state-owned enterprise (especially if it is a bureaucratic monopoly, but not necessarily only then) is to be as large and as complicated as possible in order to maximize the non-monetary advantages we have talked about. It has strong incentives to prove that what it does is not easy, that it needs more staff and equipment, without any apparent upper limits. We could take the case of the FPS, created with the purpose of dissolving itself. The managers of such agencies are reasonable persons who should not be expected to be keen to lose their good jobs.
d) The stronger state-control of the economy, the more transactions occur among state-agencies: Take the case of a state-owned enterprise dealing with the administrators of the state budget when asking for money or when seeking exemption from taxation. A problem, besides the fact that both parties exhibit the behavior described under a), b), and c), is that the same entity is behind both parties: the state. These transactions are nothing but a shift of resources from one pocket to another. Since the shifts are designed to be complicated, the result is the endurance of agencies and the creation of intermediary agencies. When gaining bad reputations, these agencies' names and surface structures are changed (such as from FPS to APAPS).

The general conclusion is that this kind of enterprise does things that are worth much less than they cost. And that all these costs are paid by the tax-payer. At the personal level of the managers and employees of the state, of course, this waste of resources is rational, but at the aggregate level of the economy, the allocation is irrational, the money obtained from taxes is not used efficiently.

An implication of the assumption that an invisible hand in an unhampered market is the approximate guidepost for the “rational allocation of resources" is that any form of coercive taxation, especially if difficult to predict, acts as a disturbing force. It redistributes resources otherwise subjected to distribution by market mechanisms (whereby the resources go to the highest bidder). It can thereby generate more lack of financial indiscipline at an aggregate level. There are many ways to collect more taxes, other than the obvious ones of increasing taxes and enlarging the taxable area; all of these measures contain a degree of unpredictability, which increases their potential distorting effects. These effects include the following:

- inflation (offering preferential credit, subsidies, bail-outs, etc. to companies on a large scale increases the offer of money and decreases its value; ultimately the people prove to have "invested" in that company by paying more for all its products, which have become more expensive due to the devaluation of the currency).
- budget deficit (spending more than collected; to collect more, the government sells bonds to the banks; but the demand for money makes the interest rate rise, thus depressing private investment).
- price increases in the finite products or raw materials owned by the state (in Romania this occurs with respect to utility prices; the people are made to buy more expensively than they should, thus covering the arrears of the inefficient enterprises).

The unpredictability of the effects of these measures stems from the fact that no one, not even the Government itself, the author of such measures, can predict with any certainty the next years’ equations relating interest rates, deficit, inflation, and price developments. To all this is added the lack of predictability of new privatization laws and property regulations, all factors working to create a non-secure climate for investment.

All the above represent factors potentially encouraging transfers of resources from the disciplined sector to the “undisciplined” one, and from the (potentially) private sector to the black holes of the state-owned enterprises. In light of the above theoretical arguments, we will now examine the empirical reality of Romania’s history of applying IMF norms on financial discipline.

The most patent form of lack of financial discipline in recent Romanian history, arrears, has not decreased; on the contrary. The salary fund for the state sector also has not decreased; again on the contrary. And the size of the governmental agencies has increased as well, Romania having more than twice the ministry staff of any other country in Europe. All that has been achieved has been:

a) a covering up of losses by moving them from one pocket to another pocket, thus losing time, instead of really re-investing resources;

b) a redistribution away from the financially more disciplined economic agents (those who registered some profit), be they regular citizens or firms.

Almost all measures taken ostensibly to improve financial discipline were slow and ineffective. The slowness of the process of privatization - which is the best if not the only way to get rid of the black holes - perpetuated the problem of arrears and the process of redistribution and irrational allocation of resources: Money was needed all the time to stuff the black holes.

An important interest of any government is its own endurance. The way to endure for a Romanian government, up until today, is gaining the huge electoral block of the state sector, along with the retired persons receiving their pensions from the state. Now it seems clear why these problems of the economy in general (problems of the tax-payers) do not also represent personal problems of the members of government. There is a need for other incentives for financial discipline. This is precisely the role of the IMF. The IMF sets some conditions to be attained by macroeconomic policies that can only be fulfilled by structural reform. However, since the structural reform is so slow, the conclusion can only be that IMF pressure is a too weak an incentive for the government.

Improving *all* macro-economic indicators (increasing GDP, lowering the inflation rate, optimizing exchange rates, minimizing the budget deficit) is not possible unless structural reform (financial discipline stimulated through privatization) takes off. Success privatization cases do exist. For the first time in the last 60 years, private share capital reached over half of the total share capital in Romania last year.[78] This looks like a success, but only if we ignore the costs of time and the costs of supporting the black holes of the state-sector for all these years. Such successes could have been achieved much earlier. Take for instance the case of Sidex-Galati. On July 27th 2001, Radu Sarbu, the former president of FPS, announced the planned privatization of Sidex during the PDSR mandate for some tens of millions of dollars. This would be a good deal, but we should remember that in the autumn of 2000 privatization was delayed by the actions of the unions encouraged by the same PDSR to block the privatization process by stopping the transformation of Sidex's debts into shares. The aim was to delay the privatization process until some real offer would be made, the real value of Sidex allegedly (even considering its debts) being somewhere at USD 5 or 6 billion. In the meantime, the delay caused losses of hundreds of thousands of dollars, with direct consequences for share prices. We can easily extend this line of criticism back in time, seeing that Sarbu himself decided to privatize Sidex a little late, in the autumn of 2000. We can also extend it to companies other than Sidex. The arguments presented above help explain why privatization did not occur in a timely manner, why the business was dallied: because there were incentives to dally, and few incentives not to.

The problem became more serious in time. For example, the "targeted level" for arrears for the period of January to March 2002 asked for a lowering by 4%, but in these three months alone the arrears of the utilities companies increased by 10%. On the 28th of November 2002, in a press release, the Public Administration Ministry recognized that debts to Termoelectrica, Electrica, Distrigaz Sud and Nord, Petrom, etc. amounted to more than ROL 29,500 billion plus another 28,679 billion from home consumers, and announced the "solution": the creation of another special monitoring commission. It seems a little bit late to start monitoring; if they have already been monitoring the situation, then why do we need another commission?

In the year 2000, after ten years of lack of financial discipline and after six memoranda published in the *Monitorul Oficial* which repeatedly made the commitment to solve the problem, the Government finally issued an ordinance (no. 58 of the 24th of May) in which it forbid increases to the wage fund in the state sector and announced that the salaries for company directors would be no higher than those for subsecretaries of state and that bonuses would be conditioned on some targeted payment of arrears. The

[78] National Television, tvr.ro, January 6th 2003, 08:27.

Government singled out this ordinance in the 16/05/2000 Memorandum, specifying that in the case of a rising level of arrears, the salaries of the managers shall be cut proportionally with the sum of arrears, but only up to the limit of a 30% cut. The fine for breaking this law is no more than ROL 50 million per 100 million. But this percentage has no special significance. Why 30%? The calculus made by any manager will be a comparison between the marginal utility of the salary and the marginal utility of his previous-style advantages. The latter are, most surely, much greater than 30% of the salary given by the state plus the fine for breaking the law divided by the probability of getting caught. There is no reason to believe that the relative marginal utility is reflected in the percentage stipulated by the governmental ordinance. The budget deficit in the year 2000 was ROL 29,090 trillion, which is more than 3.7% of the GDP. The interesting thing is that the biggest discrepancies between planned and actual expenses (ROL 429 billion) occurred precisely at APAPS.[79]

We have seen that the move towards a more efficient system of allocating resources has been directly proportional to the level of privatization in Romania. This level has been relatively low the whole time. IMF involvement has been beneficial, but not to a critical extent. Even if all conditions in one memorandum would be successfully fulfilled, this would not necessarily mean a large the overall impact of the IMF on the evolution of economic policy in Romania, since conditionality evolves flexibly from memorandum to memorandum, adapting to low expectations from the government's administrative capacity.

The real help that the IMF has provided has not been the money (318 million SDR at most in one year, in 1992), but that it has brought Romania, and still brings it, into the realm of vision of international firms and banks. The IMF has functioned in Romania as not much more than an emergency break when it comes to the problem of financial discipline. Without international involvement as a whole, however, significant portions of the elites in post-communist transition countries might still not be so open to privatization, not even in rhetoric.

The IMF also has the role of a substitute for the economics lessons Romanian producers and consumers might learn if they were part of a pan-European free market. The situation is, however, complicated by directives that come in contradiction with the urgency of structural reforms, directives targeting the protection of the environment and social protection, for example. EU conditionality is clearly contradictory in this respect: Striving for a free market in Romania is not compatible with environmental conditionality and social protection at European standards. (Romania does not have a pie to redistribute.) The IMF does not seem to take this problem into sufficient consideration. Another problem is that it has offered credibility (since its appearance is that of a voice of reason, a herald of the wealthy and experienced world) to the government, independent of the latter's actual performance.

## 7. Macro-Economic Indicators

When trying to assess the impact of the IMF on the development of a country's economy, one immediately exposes oneself to direct fire from a wide range of critiques. First of all, there is widely shared opinion that IMF programs have generally had a

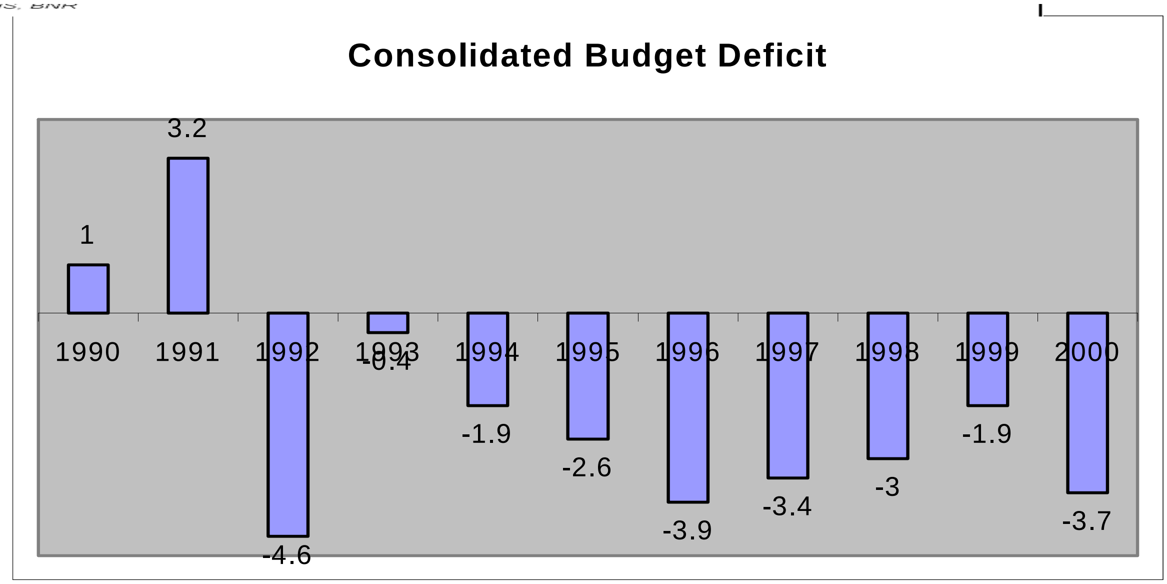
[79] *Actualitatea Economica*, February 19th 2001.

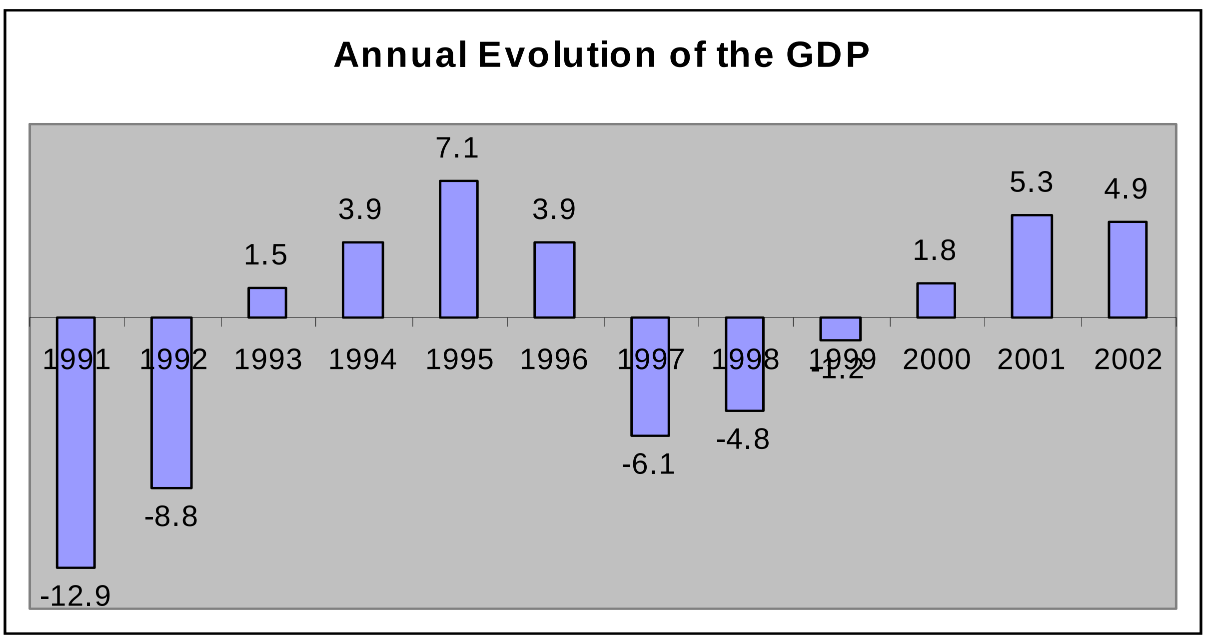
negative impact on developing economies.[80] Furthermore, the effects of the Fund's undertakings are hard to quantify due to methodological limitations.[81] Many difficulties are encountered when trying to select adequate performance indicators that can reveal a country's compliance with the provisions agreed upon in the stand-by agreements.

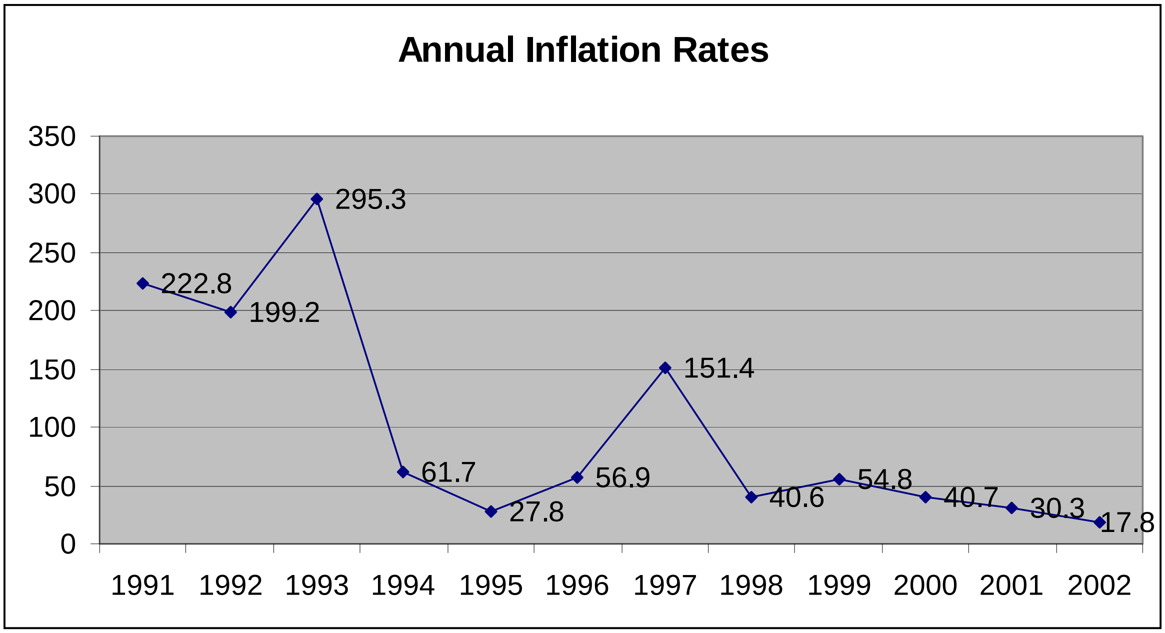
Among the general areas of activity of the IMF, financial assistance is the most important way of affecting a member country's economic conduct, especially when dealing with a transition economy like Romania's. In practice this includes credits and loans extended to the Romanian government in order to support policies of adjustment and reform.[82] The most important loan agreements in the case of Romania have taken the form of stand-by agreements Besides issues such as balance of payments, the improvement of which is the chief objective of IMF programs, and macroeconomic indicators in general (such as annual inflation rate, national official reserves, exchange rate, and level of exports), a number of particular items have added to the conditionality of each consecutive agreement. When accomplished, these accompanying elements help increase the relevance of the macroeconomic indicators taken as performance indicators. However, this move towards an ever-increasing pool of solutions addressing the same basic problems may prove counter-productive, affecting the speed and the dimension of the implementation process.

There are two conditions that explain the re-occurrence of essentially the same targets for macroeconomic indicators in all the stand-by agreements that different Romanian governments have negotiated and signed with the IMF since 1989. First, the changes brought by the transition affected the Romanian economy for the worse, due to the international framework in which the country had to perform coupled with the country's inability to reform in time to meet the challenges of market competition. Second, each consecutive agreement added elements of conditionality that were linked to the achievement of the target indicators. It is mostly this latter element of conditionality dynamics that this section will concentrate on revealing.

[80] Tony Killick, *IMF Programs in Developing Countries.*
[81] Tony Killick, *IMF Programs in Developing Countries.*
[82] Website of the IMF Resident Representative Office in Bucharest, http://www.fmi.ro.


Consolidated Budget Deficit
1
3.2
-4.6
-0.4
-1.9
-2.6
-3.9
-3.4
-3
-1.9
-3.7
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000


Annual Evolution of the GDP
-12.9
-8.8
1.5
3.9
7.1
3.9
-6.1
-4.8
-1.2
1.8
5.3
4.9
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002




The evolution of the macroeconomic indicators traced in the charts above[83] does not expose clear patterns. Only inflation seems to have followed a general downward trend, except for the first years after the election years, i.e. 1993 and 1997. The message of these figures is that the governments coming into power have based their different programs of economic reform on the same mechanism, i.e. acceptance of a high inflation rate to start with followed by efforts in the next three years in office to reduce the annual rates. Another, perhaps counterintuitive, observation that can be made only by looking at the annual inflation rates is that the election year is the one with the smallest inflation rate, out of the four years in which each government was in power. It seems clear that an election year influences the achievement of macroeconomic targets to some degree.

IMF conditionality relates to the "three stages of transition in a transition economy,"[84] its involvement depending on the stage the country is in. According to Graeme Justice, Romania still finds itself in "a very early stage in terms of macroeconomic and structural reform; and the focus [of the IMF] in countries like this is

[83] Source: Romanian National Bank, www.bnro.ro/statistice.
[84] Interview with Graeme Justice, May 9th 2003.

on the macroeconomic stabilization."[85] In light of this explanation we can now further analyze the stand-by agreements, their vision and their projected accomplishments for economic reform, with a specific focus on the improvement of macroeconomic indicators.

**1992 Memorandum Regarding the Economic Policy of the Romanian Government**[86]

- Recent evolutions: Real GDP fell by 13% under the 1990 level, industrial production by 21% under the 1990 level; there were 337,500 unemployed, out of which 266,000 were receiving unemployment benefits; nominal prices rose by 345%, exchange rate unification brought an exchange rate of 180 lei to the dollar (up from 60); nominal salaries decreased by 22% since the liberalization of prices (in November 1990); the reserves of BNR have fallen by 822 million dollars; the budget deficit only amounted to 0.8% of GDP (compared to 2% predicted).
- Factors determining the situation: absence of foreign investment; decline in commerce with the USSR and MEAC[87] countries; problems related with the Gulf crisis; lack of raw materials and outside energy sources; blockages in the payment system due to company arrears; floods and agricultural reform contributed to the decline in agricultural productivity.
- Goals of macroeconomic policy for the year 1992: stopping the decline in economic growth; reducing inflation from 15%/month to 1.2%/month by the end of the year; increasing the international currency reserves so as to cover 1.7 months of import expenses by the end of the year; further price liberalization; privatization; strengthening financial discipline by closing or restructuring state-owned enterprises; continuing financial and fiscal reforms.
- Means of achieving the above stated goals: prudent financial and monetary policies; limitation of salary increase through a tight income policy; flexible exchange rate; macroeconomic and structural policies.
- Expectations for the near future (until 1995): deficit of 2% of GDP; income from national taxation schemes of 33.5% of GDP as compared with 36.7% in the previous year; increase in international reserves of BNR by 476 million dollars; establishment of FPP and FPS, holding 30% and 70%, respectively, of the state's shares in the 6,000 companies subject to privatization; lower customs taxes and less imports of forbidden goods; USD 200 million foreign direct investment.

**1994 Memorandum Regarding the Economic Policy of the Romanian Government**[88]

- Recent evolutions: increased inflation; depreciation of exchange rates; low level of national reserves in foreign currency.
- Factors: slackening financial discipline in state-owned enterprises; external shocks and insufficient foreign direct investment.

[85] Interview with Graeme Justice, May 9th 2003.

[86] Law 64/July 8th 1992, regarding the stand-by arrangement between the IMF and the Romanian government, published in *Monitorul Oficial*, no. 161, July 14th 1992.

[87] MEAC is the Mutual Economic Aid Council (in Romanian Consiliul de Ajutor Economic Reciproc), a type of OECD for the countries of Central and Eastern Europe.

[88] Governmental Ordinance 61/August 24th 1994, regarding the stand-by arrangement between the IMF and the Romanian government, published in *Monitorul Oficial*, no. 247, August 31st 1994.

- Goals of economic policy: priority: combating inflation; budgetary restrictions and reduction of arrears of state-owned enterprises; improving financial discipline in loss-making public firms; accelerated restructuring and privatization.
- Means: reducing inflation rate from 314% to 75% by the end of the year 1994, and to 35% by the end of 1995; strict control of public expenses; a better system of collecting taxes; decreasing direct subsidies; blocking 40% of expenses for the final quarter of the year if income is under projected levels; 18% VAT.
- Expectations: current account deficit from 8%/GDP in 1992 to 2%/GDP in 1997; 4% economic growth/year; inflation rate under 10%/year; national reserves equivalent to 2.5 months of import expenses by the end of the year and 3.3 months by 1997; consolidated budget deficit no more than 2.5%/GDP.

**1997 Memorandum Regarding the Economic Policy of the Romanian Government**[89]

- Recent evolutions: 10% inflation rate for December 1996 only; current account deficit rose from USD 0.5 billion in 1994 to USD 2.3 billion in 1996 and was mostly paid for by means of short-term loans; annual average rebates will increase from USD 900 million for the period 1994-1996 to USD 1.6 billion for the period 1991-2001; consolidated budget deficit increased from 1.9% of GDP in 1994 to 5.7% of GDP in 1996; flexible exchange rate was abandoned in March 1996; increase in rebates by 2% of GDP for the year 1997.
- Factors: increase in the volume of pensions and subsidies; arrears tolerated in tax payments as means to support loss-making state-held enterprises; deficits occurred also due to excessive increase in salaries and delays in adjusting state-controlled prices; high level of state property and control in the economy; increased subsidies in order to maintain production levels and to utilize the workforce.
- Goals of macroeconomic policy: reducing the general consolidated budget deficit by means of a substantial fiscal adjustment; increasing controlled prices; efficient income policy; strengthening financial discipline.
- Means: strong monetary and (foreign) currency policies; subsidies to agriculture and the energy sector to be financed by the national budget exclusively, removing the pressure from monetary policy; BNR to no longer agree to directed loans, only those based on performance criteria; privatization and restructuring of the agricultural and energy sectors, including closing down of loss-making enterprises,
- Expectations: a 1997 inflation rate of 90%; external account deficit decrease from USD 2.3 billion in 1996 to 1.4 billion in 1997; BNR's external actives up by USD 650 million by the end of 1997; a fall in the GDP by 1-2% in 1997; general consolidated budget deficit decrease from 5.7% of GDP in 1996 to 3.7% in 1997; reduced expenses for reforms, social programs, support for agriculture, and minimal income schemes from 31.9% of GDP in 1996 to 31.3% of GDP in 1997.

There are two main elements that set this stand-by arrangement apart from the previous ones: the immense quantity of elements of conditionality and the specificity of performance criteria. If the previous agreements could have been structured on the basis of the specified five categories (i.e. recent evolutions, factors determining those evolutions, goals of macroeconomic policy, means of achieving the targets, and finally,

[89] Governmental Ordinance 30/August 25th 1997, regarding the stand-by arrangement between the IMF and the Romanian government, published in *Monitorul Oficial*, no. 215, August 28th 1997.

expectations for the near future) the 1997 memorandum fails to fit this framework because of added conditionality. The framework falls apart with this agreement and also fails to structure the following agreements in 1999 and 2001. There is a drastic increase in both the number and the specificity of the elements of conditionality (or simply the "means"). There are full chapters developed on issues as broad as agriculture, monetary and exchange rate policies, controlled prices, income policy and financial discipline, or balance of payments and foreign debt. These are only the most important chapters and they are divided into subchapters to provide a still more detailed perspective, ranging from a full-drawn plan for pension system reform (which establishes age limits, fund allocation rules, and the request for a new pension law) to provisions for increasing the VAT from 9 to 18% for fruit and vegetables.

The second element of distinction is the incorporation of 13 performance criteria in absolute figures, set for the near future. These are all limits and ceilings and make up for the bulky annexes, which claim half of the total written expanse of the arrangement.

This process of increasing conditionality is known in IMF jargon as "program creep" or "mission creep"[90] and is explained as a move from an initial program focused on macroeconomic performance to increasing concern with microeconomic factors, as they are revealed as causes for the problems that arise along the way to macroeconomic stabilization. For example, the Romanian government finds itself in a fix when trying to privatize state-owned enterprises because of the arrears situation. When investigating this aspect the problem is found to lie with high expenses controllable through wage policy; hence a new provision is added in the next arrangement that would address wage policies in state-owned enterprises. The problem may go deeper when there is no bid for the acquisition of the companies, for example because employment within them should be cut dramatically. In this way, lay-off provisions will also appear in the next stand-by agreement in addition to the general privatization policy. And the "creep" can go on and on, starting from macroeconomic concerns and getting down to the management of individual plants.

The 1999 stand-by agreement came in a very difficult moment for Romania. In this year the country was considered very close to defaulting, due to the accumulation of debt to be serviced plus due repayments. To make matters worse, the country's very low international ratings meant that it could get virtually no help from outside to alleviate this disastrous situation. The much-needed help to rescue a minimal level of confidence in the Romanian economy could thus come only from one direction, from the IMF. This helps explain why the IMF agreed to support the Romanian economy in that year with the largest amount of financial assistance since 1989, 400 million SDR.

The problems facing the Romanian economy are made clear in the "Introduction" and the "General Framework" of the 1999 memorandum regarding economic policies: acute macroeconomic disequilibrium; structural set-backs in the enterprise and banking systems; important external imbalances. The Romanian economy was facing challenges both from inside the country and from the more competitive external markets. The war in Yugoslavia also upset the balance of payments, since some estimated USD 200 million

[90] Interview with Graeme Justice, May 9th 2003.

were lost due to it in 1999 alone.[91] The outcome was a decline in all-macroeconomic indicators in the first part of the year and an attempt at a severe austerity program of macroeconomic and structural policy reform.

The objectives stated in this stand-by agreement were a step behind the “program creep” developed in the previous agreement: diminishing the current account deficit; further lowering the inflation rate; and establishing conditions for sustainable growth through a set of macroeconomic and structural policies. Again we find vague and general provisions that are backed by only two means of achievement, that is fiscal consolidation and reduction in losses produced by state-owned enterprises (this time also including banks).

However, the first step had been made towards specific conditionality, and this explains the presence of four “explicit” objectives that needed to be attained: a significant reduction of the consolidated budget deficit; limiting wage increases in the public sector to remain below the inflation rate and the rate of currency depreciation; maintaining strict conditions when issuing credits; and reducing losses in the public sector, together with an increased role for the private sector in the economy. The performance criteria established by the IMF are also two elements short, numbering eleven tasks (compared with the 13 limits and ceilings of the 1997 arrangement), split into four chapters for a better assessment of their fulfillment.

One reasonable observation after evaluating the 1999 stand-by agreement between the IMF and the Romanian government is that the Fund is flexible enough to adapt to the country's (difficult) situation. This does not, however, necessarily imply a slackening in conditionality towards the receiving country. The provisions are overall general, getting into detail only with salient issues with immediate impact on the recovery of the economy. The annex dedicated to the performance criteria mentions the tasks already fulfilled by the Romanian government and also the stage of development and schedule for the remaining ones. There is also a lesson in adaptation that the government was quick to learn, even as it makes sense neither from a supply- nor a demand-side perspective. This is the habit of increasing salaries to always remain just below the inflation rate. This keeps the purchasing power of the numerous public sector employees low, thus affecting the pace of economic recovery by depressing demand, while it simultaneously misses the target of reducing inflation because of an unwillingness to institute more drastic cuts.

The current stand-by agreement is the closest Romania has ever gotten to completing one, as there is only one more review in the way of the release of the final tranch of the loan. The IMF Board has completed an evaluation of Romania based on the report made by an IMF delegation that conferred with the Romanian authorities in late 2002. In this evaluation the Fund commended the Romanian authorities on the progress made in solving several chronic macroeconomic problems. The IMF also finds Romania’s macroeconomic situation encouraging. Relevant progress has been noted in cutting the budget deficit, lowering the inflation rate and consolidating the foreign accounts.[92]

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[91] Governmental Ordinance 76/August 30th 1999, regarding the approval of the stand-by arrangement between the Romanian government and the IMF, published in *Monitorul Oficial*, no. 422, August 31st 1999.

[92] National Television, tvr.ro, January 20th 2003, 08:17.

Romania accomplished a 5% growth in 2002 and thus exceeded the 4.5% target. This result has come with a current account deficit drop to below 4% of the GDP, as well as with a USD 2 billion increase in the foreign currency reserve. Romania's exports reached USD 13.8 billion in 2002, up by nearly 22% against 2001. According to BNR Governor Mugur Isarescu, exports will continue to fuel economic growth in 2003, and so will investments and consumption. However, according to Isarescu, consumption will need careful monitoring in order to avoid a renewed increase in inflation.[93]

Judging from the facts revealed above, it looks like the situation of the Romanian economy has improved, the macroeconomic indicators are on target (and some even exceed the previous forecasts), and "program creep" and its bulky microeconomic conditionality are all a thing of the past. This picture is, however, far from the real truth, as old habits die hard and microeconomic conditionality is back on the menu, stronger and more extensive than ever. Bearing in mind that the Fund officially focuses only on "macroeconomic stabilization,"[94] one is most probably puzzled to find out that the release of the fourth tranch of the current loan is specifically conditioned on (among other measures) the privatization of BCR and Petrom. This is perhaps a good opportunity to accuse the IMF of inconsistency with its statutory objectives, as it clearly goes beyond its role of monitor of the world's currencies and lender of the last resort in situations of balance-of-payment crisis.[95] According to Graeme Justice, "there is a debate within the Board of Directors and the management of the Fund about whether creating the conditions for growth is its job; some say that's what the World Bank does instead. We should have programs of 16 months and that's it!"[96] Justice goes on to explain the predicament the Fund has found itself in by relating to the example of Ukraine. After succeeding in helping to stabilize the country the IMF left and Ukraine entered the world capital markets to borrow again. In a few years the country's debt had skyrocketed from zero to "unsustainable levels."[97] In the end the Fund was asked to return.

The Fund is now facing a tough decision, having the Ukrainian example (which is also that of some African countries), on the one side, and, on the other, the strong current from within the IMF pushing to "change the type of programs in countries where there has been a long history of poor performance."[98] Unfortunately Romania falls right in the middle, because here the IMF is neither precisely carrying out its traditional *modus operandi*, nor is it going for a change in the program. It seems to just take the middle way, allowing some extent of program creep and hoping for improvement of macroeconomic indicators.

In this context, it is interesting to compare the medium-term objectives of the 2001 arrangement with the previous ones, starting with the one agreed upon in 1994, which includes such objectives as prospects for the near future. The objectives of the agreements are almost the same, independent of changes in approaching interaction with the successive governments of Romania. And we must stress once more that the original and official area of concern for the IMF is macroeconomic performance. The medium-

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93 *Ziarul Financiar*, February 7th 2003.
94 Interview with Graeme Justice, May 9th 2003.
95 Website of the IMF Resident Representative Office in Bucharest, http://www.fmi.ro.
96 Interview with Graeme Justice, May 9th 2003.
97 Interview with Graeme Justice, May 9th 2003.
98 Interview with Graeme Justice, May 9th 2003.

term macroeconomic objectives (for the period 2001-2005) stated in the 2001 memorandum on economic and financial policy are self-explanatory: a one-digit inflation rate; a current account deficit of 5% of GDP; a growth rate of 5-6% per year.[99]

The 1994 stand-by agreement was the first to encompass medium-term objectives (also for five years' time), perhaps because it was considered that the economy was on the right track and able to achieve the following indicators: a one-digit inflation rate; a current account deficit of 2% of GDP; a growth rate of 4% per year. This looks strangely familiar to the 2001 objectives, excepting perhaps the too-optimistic current account deficit rate. What happened in the seven years between 1994 and 2001 can be best described in IMF terminology by two words: "program creep".

It is, however, misleading to conclude that the IMF's involvement has had no impact on Romania's conduct in economy and social policy, based only on the looks of the macroeconomic indicators. The 1997 and 1999 agreements included no medium-term objectives, mainly because the Romanian economy was in such a bad shape that any short-term evolution was uncertain, making any predictions for the future seem unrealistic. By 2001 the situation had mended, so that forecasts could be launched again concerning future prospects for Romanian economic well being.

It is important for Romania to look good to the outside world, but how close the new improved image is to the truth is hard to tell. While it has generally followed the strategy towards macroeconomic recovery advocated by the IMF, it is also difficult to tell how much of that recovery, such as it is, is the direct result of IMF intervention. One area in which the IMF has undoubtedly had a significant impact is in identifying where the difficulties in the process of economic reform lie and which are the possible ways to tackle these problems. It clearly has a policy-formulating, rather than a policy-implementing impact. This observation is also supported by the IMF's relative rigidity in negotiations to develop targets and guidelines, and its relative flexibility in supervising their implementation when the situation might instead call for continued adaptation. In the end, all the IMF can rightfully claim as of yet as clear accomplishments in the Romanian case are successes in its typical, statutory areas of activity, i.e. financial assistance for macroeconomic stabilization. Whether another nanny could have done better with this particular obnoxious child remains doubtful.

## 7. Conclusions

Beginning from its designated objective of assisting Romania in its transition-related balance-of-payment difficulties and supporting the stabilization of macroeconomic indicators in the country's new market economy, the IMF has, throughout the post-revolutionary period, become progressively more involved in micro-managing restructuring. This so-called "mission creep" has led to the addition of conditions to stand-by agreements which aim at removing the causes for the slow pace of macroeconomic recovery. In the quest for stabilization and improvement of inflation, exchange, and growth rates, the IMF has not only consistently pushed for more rapid privatization, but also for reduced public expenditure on wages, greater financial discipline in state-owned enterprises, and reduction of arrears.

With respect to privatization, the main role of the IMF has been to back up the involvement of the World Bank by supporting the acceleration of the process. Unlike the

[99] Website of the IMF Resident Representative Office in Bucharest, http://www.fmi.ro.

World Bank, the IMF is not involved in developing privatization strategy, except for the banking sector, where it applies special expertise and is an important non-domestic influence. The extent of the impact of its general encouragement of more rapid privatization as compared to that of other actors is difficult to assess. It is, however, obvious that there has been some impact and that its nature has encouraged progress in privatization in Romania.

One of the factors which have inhibited progress in privatization has been the arrears problem, which has slowly but steadily worked its way up the IMF's agenda and into the memoranda. The IMF has increased pressure on the Romanian government to handle this problem more effectively. The results have been very limited so far. The same is true for the demand for "wage discipline," another problem that bears directly on the chances for privatization as well as on the public budget. The aim to limit public wage expenses entered Romania's agenda of cooperation with the IMF largely as an "emergency break" measure, a result of the failure to push through structural reforms, such as privatization and liquidation, and to tackle the problem of arrears and the lack of financial discipline in the state-owned half of the economy. Greater financial discipline in the state-owned sector, finally, continues to be an unmet condition, which may, from the viewpoint of liberal economic theory, even be considered unmeetable because paradoxical.

The overall direction of the impact of IMF involvement in Romania is clear: The IMF has applied consistent pressure to combat inflation through keeping demand low, thus leading the country away from any potential demand-driven recovery of growth and living standards. Related policies equally in conflict with demand-side economics have been consistent downward pressure on public spending and in particular on public wages and discouragement of deficit spending. Social pressure is further increased by the push to downsize or close inefficient state-owned enterprises and public institutions. The twin engines of growth are expected to be privatization and liberalization. For more successfully attracting investors, whose activity can stimulate production and trade, ultimately lowering unemployment and increasing private wealth, again, the advocated means are low personnel expenses achieved both through downsizing of the affected companies and through low wages, as well as the solution of arrears problems, which could simultaneously lead to a recovery of the state budget.

Our research has provided us with a more detailed picture of the nature of IMF strategy for Romania than that which emerges from the simple assertion that the IMF represents the "Washington consensus," even as we can only sketch some contours of this picture here. As for the extent of the impact achieved by IMF strategy for Romania, it is fair to say that the IMF's main demands have largely been continually disappointed. This does not, however, mean that the impact has been insignificant. The direction into which Romania has been prodded so apparently gently (considering the IMF's continued support) is clear. How much of the limited progress with respect to the criteria identified in the stand-by agreements since 1989 is due to the IMF, as opposed to other actors, is, however, impossible to precisely assess. Concrete influence is evident in the privatization of the banking sector, in measures to reduce inter-company and state-company – public budget arrears, in keeping wages in the public sector lower than they would likely otherwise be, and more generally in the employment of restrictive monetary and budgetary policy before the backdrop of liberalization. This general approach to economic and social policy is inspired by the IMF's supply-side economic philosophy and emphasis on macroeconomic stabilization as opposed to planned development.

Currently, macroeconomic indicators can reasonably be interpreted to signal a beginning recovery of the Romanian economy. Whether this recovery is due to what limited progress has been achieved with respect to the IMF's conditions is a question which cannot be definitively answered. What can be said with certainty is that wherever Romania has maneuvered itself, it did not get there on its own. The influence of international organizations and other external actors on economic and social (as well as other) policy in Romania since 1989 has been extremely strong. The country's international socialization and "re-education" are ongoing, and its level of transnationalization continually increasing. The nexus between the international and the domestic is a highly relevant subject for further study, as Romanians as well as the rest of the world's people aspiring to live democratically must evaluate the effects of transnational norm transfusion on their personal welfare in order to develop a voice.

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