The Romanian banking system after twelve years of transition
towards a global market economy

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Most participants at this conference will be well aware of the historical evolution of banks, and the central role of credit in a capitalist society. However, as Post Keynesian denizens of advanced capitalist economies, your focus is likely to be on the destabilising impact of a pervasive speculative financial culture (c.f. Minsky). Let me tell you a cautionary tale from the other extremity of capitalism, where a market-oriented financial system was dismantled, a centralised replacement imposed as part of a moribund society, and where we are now trying to reconstruct a viable financial system that supports capitalist enterprise.

Firstly, I should remind you that finance, saving and accumulation are not purely quantitative phenomena. Each society has its own way of saving, of spending, its own prejudices, incentives and obstacles to investment. Politics also plays its role in the formation and use of capital. Taxation restrains and siphons private money, changing its orientation and returning it, in a more or less useful way, more and less quickly. Pre-socialist Romania had its own particular national financial system, but in the twist of fate that was the aftermath of the World War II, the role of the banking system was entirely subordinated to Communist Party policy.

The Romanian banking system was reduced to a central bank and four state-owned capital banks. For half a century, bankers no longer played a key role in our society. Banks were
scaled down and reorganized in a manner consistent with central planning—which is better described as bureaucratic centralism.

In this period, we lost sight of many of the aspects of banking in a market economy that you take for granted—perhaps rather too much for granted.

The superiority of capitalism over bureaucratic centralism resides in the fact that its decentralised structures better enable change, and allow a range of strategies (including that of waiting). Of course, those holding the privilege of market information also benefit from the support of state and society, and strategy is not the only key to success: both the prudent man and the imprudent can either make a fortune or go bankrupt. The capitalist spirit proclaimed by Werner Sombat and Max Weber is not the only explanation for success. Economy, society, culture and politics play a certain role as well.

Nevertheless, capitalism implies apprenticeship. Acquiring knowledge and information is a condition for survival. It takes calculation, logical reasoning and the desire to win but also initiative and willingness to assume risks. All this defines the spirit of a capitalist.

The market economy in which capitalists play is a complex game with frequent unpredictable developments. Market economy mechanisms are sophisticated and to understand them requires knowledge, reflection and a sharp mind. As an important part of the market, the banking system has its own obligations focused not only on maximizing its own profit, but on providing credit in a manner than can contribute to the general development of the nation.

None of this mattered to the banking system of the Soviet period. This was a totalitarian economy, which was too little or not at all used to taking risks. Employees got their insufficient but sure wages; money and prices were planned and simulated stability:
Companies were threatened neither by unemployment nor by bankruptcy. Competition was totally ignored and a false concept of “the socialist challenge” was developed by the political decision makers. Unemployment was dismissed as an economic phenomenon, but the reality of economic indolence meant that a different manifestation of it appeared at the level of market demand. This myth of no unemployment was but an escape from reality, or from its decentralized reality at company level. The result: empty shops—empty of consumer goods, at least. Beyond the semblance of stability and the absence of uncertainty, the economy was menaced by huge concentrated risks, amplified at the national scale.

After December 1989, we began the process of moving from centralisation to market. But economic decentralization necessarily implies decentralization of risk. This fact is often forgotten nowadays: the new system can only be one in which each company, bank or shop assumes its own risk. Our days of worrying about systemic risk lie ahead of us—though we have also experienced systemic risk in the transition process.

One of the keys to the this reform must be to create a market-oriented, decentralized banking system. Because it is a sure thing that without strong and profitable banks, the Romanian market economy will not be rescued—as we like to put it.

The new economy could not and cannot be based but on a system of free markets—for goods, services, labor, and money. Within this system, banks cannot be imagined as a “perfectly aligned” row of “disciplined” commercial banks, which obey the orders of the commander-in-chief, the central bank. If it could it be so, speaking about free markets or free enterprise would be pointless, and we would instead return to the former mono bank system in which all resources were distributed according to central planning. Critics of the excesses of
a competitive banking system sometimes do not pay sufficient attention to the dilemmas of its polar opposite.

The commercial banks in our EU neighbours have not only the freedom of economic enterprise, but real autonomy as well under, of course, the national bank’s rules of the game. Without a profitable, well operating banking system, a market economy would desintegrate. When banks fail or the banking system collapses, the market economy is in danger.

Ideally, bank should direct credit to businesses that can yield profits from sustainable business ventures. Neither political nor social security reasons should interfere in this. In a market economy, there are no more important laws than profit. This lesson can be forgotten through speculation, as it appears to have been in America during the internet bubble. But it can also be forgotten under too centralised a system of production and exchange.

The banking system also carries out the function of a money multiplier, stimulating investments and consumption and consequently production. To the bank should come those who entrust their savings, and for this to occur banks must rely on two factors of attractiveness: interest and confidence. Nobody confides the savings to a bank without trust in it. But profitable investments are, of course, risky as well. Banks must make a profit, but they cannot do this without risk.

This transition, from a superficially riskless but systemically fraught banking system subservient to political will, to a transparently risky but vital source of credit for private business, has been going on at the same time as Romania’s overall economy has made its difficult transition from central planning to the market.
Transition—the banking history

We set out from a mono-bank system and have developed, to some degree, a diversified one. The Romanian banking system has been growing for almost 12 years, with the number of commercial banks increasing from 6 to more that 55 at present.

But given their existing networks, the domestic market was always going to be dominated by the four large banks which still have predominantly state-owned capital—BCR, BRD, Banca Agricola, and Bancorex—that emerged from the precedent banking structure. In December 1997, these four banks held 68%, and the also public Savings Bank held 8.4% of the total assets of the banking system.

The leading position of the five banks with majority state-owned capital within the Romanian banking system is also indicated by the fact that, by the end of 1997 they held 48.95% of the paid-in registered capital, as well as 70.35% of the own funds of banks, 74.85% of the deposits in lei, and 54.50% of the foreign currency deposits in the banking system. At the same date those banks accounted 74.30% of credit non-government in lei and 71.90% of credits in foreign currency. These figures highlight the efforts that were being made for the privatization of the banks with majority state-owned capital. Today, none of them has maintained the same situation, as all of them either became mainly private owned or disappeared from the banking market.

In this context, mention should be made about NBR’s role in withstanding state pressure to set up new state-owned banks, and its support for the mushrooming of small and also unfortunately weak banks. This policy has been steadily pursued ever since 1991, but its practical outcomes have come under the shadow of the sluggish pace of the privatisation and restructuring of state-run industries. However, after the privatisation of the Banc Post, the share of majority state-owned banks in total loans and assets narrowed to just above 50%.
As regards Banca Agricola, for instance, new actions were taken to continue the restructuring pending privatisation. The restructuring plan of the bank and the strategy for privatisation were completed and approved by the State Ownership Fund in 2000. In March 2001, the Parliament of Romania passed laws on the recapitalisation of the bank, and the Government extended the validity of the privatisation bid. This provided the basis for signing of the final contract – in 2001 – for the privatisation of the bank between the State Ownership Fund and the Consortium made up of the Romanian-American Enterprise Fund and Reiffeisen Zentralbank Osterreich AG.

The year 2000 saw 2 more critical points that involved state-run banks. In May, some rumours—whose origin has not been identified yet—caused a run on the main lending bank in Romania, the Romanian Commercial Bank. To overcome this state of affairs, the NBR intervened by monitoring the bank, keeping a close contact with the managers and providing cash to meet payments. In addition to the prompt intervention to secure the sound financial standing of this bank (illustrated by its optimal liquidity and solvency ratios), was decisive in bringing its prudential indicators back to normal parameters in only one week.

The Savings Banks (CEC) faced particular circumstances following the signing of the guarantee contract with SOV invest joint-stock company in 1999. The state of affairs experienced by CEC, whose deposits are guaranteed by the state, pinpoints once again the need to speed up privatisation of banks with fully or majority state-owned capital. The restructuring of CEC pending privatisation is a top priority of the present Government program. In this respect, ING Barings Institutional & Government Advisory Service BV was appointed to carry out, in 2001, the operational audit and to draft the project for the restructuring of the bank, supported by PHARE funding.
Foreign banks have also played an important role in broadening and improving the range of banking services. Their rapid growth in market share has enhanced competition, forcing the domestic banks to increase their efficiency.

However, as with the overall transition, the transition for banking has been far from smooth sailing.

Although some of the most pressing issues have been addressed and partly solved in 1999, the activities left unfinished were continued in 2000 and 2001 and the emerging problems were duly dealt with.

In the wake of unjustified extension of lawsuits against the actions and decisions of the central bank, the fuzzy condition of Columna Bank (the head office of which was discovered to be a Swiss postal box), Dacia Felix and Credit Bank undermined, over the last years, the authority and credibility of the NBR, posing a moral threat to the financial stability of the banking system.

Therefore in June 2002 NBR revoked the licence of Columna Bank due to the blatant violation of the banking legislation and regulations in force, particularly in the field of lending an loan classification and provisioning. The decision was disputed at the Supreme Court of Justice but, finally the bankruptcy was declared.

The central bank also submitted to the Court, in July 2000, a petition for the start of bankruptcy proceedings in the case of Dacia Felix Bank, based on the bank’s failure to observe the restructuring plan as regards repayment of the credit granted be the central bank. In May 2001 the Government issued an Emergency Ordinance, allowing the extinction of the debt due to creditors by transferring their claims to KOLAL BV Amsterdam, thus paving the way for the bank to recover.
The decision to revoke the licence of Credit Bank taken by the national bank board in 1997 became final and irrevocable in 1999, and the petition for starting bankruptcy filed in 1996 by NBR as a creditor, was accepted in the court no sooner than in November 2000. The wobbly financial position displayed by Bankcooop throughout 1999 as a result of bad loans and reckless off-balance sheet commitments in the previous years inevitably led to payment default. This state of affairs could have overcome only by means of a substantial recapitalisation, estimated at more than 100 million USD. Instead, a receiver was appointed and the deposits of individuals were repaid via the Bank Deposit Guaratee Fund.

The measures taken by the national bank in 1999 to stop worsening of the financial standing of Banca Internationala a Religiilor were not accompanied by actions from the part of shareholders or managers, such as the retrieval of claims recapitalisation or the selling of the bank to a stronger shareholder. The poor financial standing revealed by the supervisory authority during on-site inspections in the previous year (but not recognised in the financial statements of BIR) was due chiefly to the large volume of bad loans for which provisions were insufficient. Poor asset and risk management resulted in a severe liquidity squeeze, and implicitly in the failure to set up required reserves. All this compelled the central bank to institute special supervision. The bank’s payment default at the beginning of March 2000 and its negative net worth led the NBR to introduce a special settlement regime and to revoke the bank’s license to operate on the stock market, the OTC market and the market for Government securities. As shareholders did not back the bank by increasing its capital, and potential investors did not show interest in buying and recapitalising the bank, bankruptcy proceedings started, and the Bank Deposit Guarantees Fund paid individuals by the end of 2000.
Starting with the latter half of 2000 there was a run on Banca Turco-Romana; depositors, natural and legal entities, submitted requests of withdrawal for deposits in both domestic and foreign currency following some articles published by newspapers. The liquidity crisis was sharpened by the bank managers’ failure to convert into cash the deposits placed fraudulently with banks abroad in the form of collateral for some lending transactions carried out by the respective banks in favour of Bayindir Holdings, and deceitfully recorded by the banks as time deposits instead of collateral deposits (in off-balance sheet accounts). The wrongful recognition of the respective commitments rendered impossible the accurate assessment of the bank’s financial standing before the breakout of the crisis. The financial and banking crisis that hit Turkey in November 2000 thwarted this endeavour. This bank therefore also ended in a bankruptcy.

The Commercial Bank ”Unirea” – private, mixed owned capital - also experienced liquidity strains as a results of the withdrawal, by the main shareholder, of a significant part of the preannounced stake to be used in increasing share capital. This state of affairs required the introduction of a special settlement regime as well.

These events led to the resumption of the special credit line, which resulted in liquidity-providing operations, while the need to minimize the harmful effects of such operations on the control over liquidity led to additional sterilization operations by the central bank.

Delay in Banca Agricola's privatization aggravated its liquidity problems and led to the need for a rescue package that involved opening by the NRB (National Bank of Romania, our central bank) of two special credit lines, outright purchases of government securities (partially used to write off a credit line granted in 1999) and the payment (based on special legislation)
of principal and interest by the NRB on some loans previously granted by Banca Agricola to the agricultural sector.

Observance of legal obligations to depositors of banks declared insolvent (Bankcooop in 1999 and Banca Internationala a Religiilor in 2000) led inevitably to additional currency issue. Thus, in order to support the Bank Deposit Guarantee Fund to repay the depositors of failed banks (given its limited capability to accumulate resources from banks), the NRB opened 2 credit lines.

The central bank thus acted as lender of last resort in dealing with the crisis caused by the collapse of the largest investment fund, with a large impact on all investors, including the depositors of the biggest bank BCR. The central bank also had to intervene to stop the panic jeopardizing the stability of the banking system. Liquidity injections caused by these interventions were mopped up through sterilization operations by the central bank, with a marginal impact on the monetary indicators.

In 2000 and 2001, the supervisory authority focused on improving the soundness of the Romanian banking system in order to bring it in line with EU accession objectives.

Although the risk of a systemic crisis declined considerably in the wake of measures taken in 1999 and 2000, the banking system remained vulnerable, due to some financially nonviable banks that failed to recover in 2000/2001. The economic environment was also unfriendly, despite the resumption of economic growth and implementation of economic policy measures agreed upon with the World Bank under the PSAL 1 Project in the last months of 1999. In 2000, a new phenomenon occurred, as some bank managers resorted to fraudulent off-balance sheet commitments to the benefit of the shareholders or third parties (Enron is not simply an
American phenomenon), which by their extent threatened to replace bad loans as the main reason behind banks' troubles, thus entailing a shift in the supervision strategy.

Against this background, the central bank implemented a consistent program for the consolidation of the banking system. The program worked in concert with the government's reform activity, and was drafted along the co-ordinates agreed upon with the international financial institutions. The chief aim of this program was to strengthen every stage of the prudential supervision of banks. This included enhancing the severity of licensing requirements on new banks and managers, amendment of regulations, improvement of bank monitoring, and the creation or streamlining of some instruments to provide indirect support to supervision: the Credit Risk Bureau, the Payment incident Bureau and the Bank Deposit Guaranty Fund.

Three new banking laws came into effect starting with 1998. They have formed a package of regulatory instruments of the upmost importance in accelerating reform of the financial sector, and laying the credit foundation of a market economy in Romania. Whereas the banking dilemmas of the West relate to restraining the degree of financial speculation, in Romania our concern is the more basic one of the need for real banks, for people and companies that know how to make money. This is a condition for the lasting economic development of our country. Romania has never lacked people who knew and even now know to make money. All they need is to be encouraged to do so within the legal framework of a market economy.

**Transition—**the economic history

This need for a strong legal and institutional framework to a market economy is evident in the outcome of our hesitant approaches to the reform process that started in 1990. These entailed the perpetuation of some major structural imbalances and enhanced economic strains.
thereby leaving room for the outbreak of a far-reaching financial crisis. A proper valuation of the current state of affairs, without preconceived opinions, as well as the enforcement of consistent, up-front measures to counter unfavorable developments, will hopefully put the Romanian economy on a sustained growth path in the long run.

At present, the Romanian economy still faces challenges that could have unfavorable financial outcomes: delays in reforms, the built-up of domestic and foreign debt, the threat of slippage into high inflation and further over depreciation of the Leu (our national currency, which in 1990 exchanged 14 to the dollar, and is currently trading at 33367 to the dollar!), and the general fragility of our still immature banking system. These challenges are closely interconnected. A sequential or segmented approach cannot produce satisfactory upshots, and might indeed cause further failures that delay the reform process.

Time is an essential factor that must be taken into account. In the past, the accumulation of disequilibria and tensions that characterized the aforementioned issues might have unleashed a crisis, though at present, the accumulation of hardships has slowed down and some economic sectors are showing positive signs. Consequently, the primary concerns in the coming months are to focus on keeping the macroeconomy under control, and continuing fast structural reforms at the enterprise level in order to reach the critical mass needed for removing tensions in the economy and resume growth.

Economic policy faced a double challenge in 2000. The domestic environment called for the breakaway from the past years downturn and putting the economy back on a sound sustainable upward path, along with a significant cut in inflation rate. But externally, the positive trade performance of 1999 had to be reinforced by keeping the current account deficit
below 4% of GDP, and bolstering official reserves in an attempt to regain the confidence of foreign investors to enable Romania to re-enter private capital markets.

Results did not match objectives. Macroeconomic indicators continued to diverge: industrial output followed a downtrend; the trade deficit widened month on month, with exports on the wane, the unemployment rate crept up, but the purchasing power of wages picked up against the backdrop of a slower rate of increase in consumer prices.

By the end of December 2001, industrial output slumped had 16.5 % month on month owing mainly to a 19.7 % decline in manufacturing output. Full year industrial output was 8.2 % higher than in 2000, due to the output gains across manufacturing and mining. Consumer prices rose by 30.3 % (at an average monthly rate of 2.2 %, down 0.7 % points year on year; the yearly growth in consumer prices averaged 34.5 % compared with 45.7 in 2000, thereby reflecting the disinflation gains in 2001).

In 2001 Romania experienced a worsening of its balance-of-payments current account deficit, which rose by 72.35% to US$2,349 million. The 76.35% climb of the trade deficit to US$2,969 million was the result of both domestic factors—the need for retooling, measures to foster economic growth, the reliance on energy imports—and external ones, such as the drastic slowdown in global trade over the past few months. Against the background of the near-doubling of the growth rate of imports compared to exports, the coverage of imports by exports fell 79.35%. By December 2001, the trade gap had widened by 56.7% month on month and 44.95% year on year, as a result of larger net imports of foodstuff from agriculture, mineral products, machinery, equipment and transport means, and lower exports of wood and paper product.
Behind this development stood the international flows of goods and, to a much smaller extent, the widening shortfall of income. Full year exports came in at US$11,385 million, up 9.85% compared to 2000, led by rising industrial output and a larger share of exports of manufactured goods, as well as export-related soft loans, and guarantees pledged for products with a long manufacturing cycle. A mix of domestic and external factors operated to bring about the full-year rise in imports, as follows: consolidation of economic growth, increase in exports under OPT arrangements, the decline in food and farm output in 2000 (whose effects lingered in the first half of 2001), the cut in domestic medicine production, incentives granted to small-and medium-sized enterprises as well as to investors, the stepped-up demand for primary energy resources, the appreciating ROL in real terms, and weak external prices.

Full-year exports to advanced countries rose by 16.25% from a year earlier while exports to transition countries and developing countries slid 6.7% and 5.25% respectively. Hence, the weight of advanced economies expanded by 4.15 points to 74.4% of total exports. With our closer ties to the European Union, the EU took 67.85% of total exports, with exports to Austria and France increasing at the fastest pace.

By contrast, export volumes to Turkey, Bulgaria, Ukraine and Moldova followed a downtrend. The geographical spread of imports painted a different picture. Imports from advanced, developing and transition economies showed increases of 20.75%, 27.45% and 13.3% respectively. Imports from advanced economies made up the largest share of the total, 65.15%, gaining 0.9% over the previous year. Romania's chief trade partners were Italy, Germany and France, and the upward drift in trade with EU member states was mirrored by heftier transactions in EUR to the detriment of the US$. 
The incomes deficit widened by 17.5% to US$335 million. This development was attributed to the payment of interest on long-term loans, and to incomes from repatriation of direct investment by non-residents. In 2001 as much as 73.6% of the current account deficit was financed via the net inflow of direct and portfolio investments by non-residents. Net foreign funding through medium- and long-term borrowings ran at US$739 million in 2001, down 43.5% on the year. Behind this development stood the decline in loans and larger payments by the monetary authority, the government, and non-banks. Gross foreign assets of the banking system surged in 2001 by US$1,534.4 million owing to the increase in both the NRB's and banks' foreign exchange reserves by US$1,471.5 million and US$66.9 million respectively. The external debt service ratio was at 20.7%, foreign currency reserves rose from 3.3 months to 3.9 months of import cover, and the share of interest payment in exports of goods and services dipped to 4.5% from 4.6% in 2000. The bold economic program for 2001, including conflicting short and long term macroeconomic objectives, represented a challenge to the monetary policy too. The stepped up disinflation, resumption of economic growth and preservation of current account adjustment that had been taken place in 1999 were heavily reliant upon the fulfillment of the original assumptions underlying the economic program.

**Transition—the prognosis**

It is important that the authorities are mindful of these matters and that each of them can be tackled. It is even more important to underscore the need for a full political will and joint action to implement these necessary measures. Restoration of economic and financial stability, and steering the economy towards a viable long-term growth path, can only be accomplished through a far-reaching approach and resolute, constant follow-up of systemic changes to which we are pledged.
The current state of affairs is still burdened by a bulk of the problems that cannot be objectively tackled in the short run, but delay in adopting bold measures could worsen the lack of credibility from which Romania still suffers.

The only way out is the imposition of hard budget constraints on enterprises (c.f. Kornai). The ongoing discussions on arrangements with the IMF and WB are focusing on fighting the inherited legacy of soft budget constraints, and the accompanying mindset of managers and workers, which triggered a perpetual waste of resources and stifled development of a profitable real sector.

Implementation of such measures must pave the way for the establishment, in the shortest possible period, of efficient corporations and sectors. Inefficient corporations and sectors, relying structurally on either explicit and implicit subsidies, should give way to profitable, value-added-generating ones.

To get such a target it is imperative that we finally shift from an extensive to an intensive economy. Very few countries, even developed ones, have resource-based economies. The basis of success is intensity: vertical growth, based on productivity and efficiency, with the key resources residing not in land, labour and homogeneous capital, but in the rational organization of production and labour. Since 1975 the Romanian authorities of both ilks have asserted that the shift from extensive to intensive development was made, but this was mere wishful thinking. Our economy was extensive in 1989, and it still is.

Economic growth during the former regime followed chiefly the horizontal path. New industrial units were set up, and to achieve their construction the accumulation rate was raised so high that it became a burden on the population. Since 1990, the accumulation rate has contracted markedly. Productive capacities have no longer been extended. On the other hand,
new sources of extensive economic growth have been found, among which the most damaging has been extensive foreign borrowings. Domestic production went up or down according to the growth or decrease in external flows. In the absence of competition, privatization and restructuring, an intensive economy could not be attained.

Romania must also return to a real open market. The supreme criterion of the market should be efficiency. The new monetary program implemented in 1997 focused on 3 main keys: to attain a market-based exchange rate, to issue currency without fuelling inflation and to attain real positive interest rates in an effort to curb inflation. But these macroeconomic objectives can’t be met without a real economy with market-determined prices. When prices were first liberalized, inflation exploded, and unfortunately little was done to correct costs. State enterprises simply raised factory prices without cutting down outlays.

The high prices covered ballooning costs and waste products, thereby encouraging maintenance of scant supply. Demand often shrank. As economic performance is now measured in real money, each enterprise should have focused on incomings, outcomings, profit. But markets convey alarming signals to many Romanian enterprises: they constantly warn that their costs run too high, while consumers complain that they are overstaffed, or waste resources, or that their products are too expensive. All these enterprises have a habit of asking for budget subsidies to overcome their problems.

The new budgetary philosophy could undoubtedly provide both constraining tools and incentives to the taxation system. Moreover, reshaping of the budget could stimulate efficient work and discourage the work that does not allow for market and consumer requirements. But the sources of revenues are the most intricate problem that no longer depends on the government’s budgetary philosophy but on the market’s economic one.
Growth in output of restructured enterprises, based on market orders—including a greater quantity added value of a better quality—would be beneficial to society. Only such a growth, reflected in GDP, could bring in real revenues to the government budget too. It appears that we are paying dearly for the host of inherently unprofitable enterprises created in Romania during the 70s and the 80s. Now, when the market in the developed countries is led by the Consumer-King, who decides what, how much and how is produced, we are still prisoners of the obsolete behavior of seeing the manufacturer as a king.

In normal market conditions, one produces only what is in demand and what can be sold, to satisfy in a real and complex manner the market requirements, and this is for the market to decide, not the producer alone. You have your overblown speculative businesses, laying optical cable on mythical projections of future demand; we have enterprises that have still not learnt to respond to current demand.

Given these conditions, we should be rescaling productive capacities so that they produce intensively, use fewer raw materials, fewer imported resources, less personnel. Romania also needs lasting economic growth to allow the macroeconomic stabilization program to be completed, and not be aborted halfway thorough, as occurred in the previous years.

At present, resilient growth cannot be accomplished with cheap money (here, perhaps, is a lesson that applies to both our economies!). We must overhaul the economy first. And we have started to do this.

Finally, we must come to terms with globalization—it is an appropriate policy that will give Romania easy access to the world market? Or will it bring further problems of internationally-generated instability and foreign debt?
The belief in Romania that globalization is an optimal solution has been gaining ground in the last few years. We must develop a thorough comprehension of globalization, of its specific features and the strengths of this global wave that perhaps offers us regional challenges and solutions. We must also take into account that the world has clear-cut limits, and that these impose major constraints as the planet is facing with a great challenge.

Making a wrong step now could be disastrous. The winds of change that blew throughout the 90's resulted in dramatically higher costs at both the economic and the social level, and therefore we simply had to deal mainly with analysis of the current trends and achievable results. But now both our material and psychological resources are limited. Both time and patience have run out.

The warning of history is of particular importance domestically. Every policy, from development strategies to the strategies on the re-allocation of resources—financial ones included—need to take this fact into account. It should also be considered in a rational manner, given the ecological limitations and constraints of the world in which we live.

The last two years evolution of our economy stirred up spirited debates about appropriate economic policy to jumpstart economic growth in Romania. The Government is not the only institution concerned about this issue. Well known non-government organizations have also made proposals aimed at resuming economic growth. But while the concern about ending recession is shared by all of us, the views about the right way to reach this target are quite varied. Experience has showed that the economic development is not necessarily achieved by “quick-fix” policies that often lead to short term but unsustainable results on the output side. To be truly beneficial, economic growth has to be sustainable. Since it is essentially a long-term process, it requires appropriate structural adjustment. While in the short tem structural
adjustments could be associated with output decline, the upside is that they will hopefully create all the ingredients that sustainable real economic growth needs. In retrospect, it appears that in Romania economic policy has been guided by the short-termed cost-minimization criterion. Measures aimed at obtaining quick results on output were constantly promoted. Thus, real measures which would have set the stage for sustainable growth during the reform process have been delayed.

For more than ten years, financial assistance for different sectors was also provided via explicit and implicit subsidies. Microeconomic behavior adapted to internalize these distorting economic incentives. The final result was unsustainable growth, attained both between 1993-1996 and 1997-1999. The Romanian experience confirms, likewise, that stabilization cannot last unless the necessary structural adjustments emerge. The two stabilization programs started in 1994 and 1997 ultimately failed. Instead of being oriented to help to bolster market initiatives, Romanian industrial policies focused on preserving the old structure of industry (the status quo). In the short run this kind of industrial policy helped economic growth, but in the long run it proved disastrous.

Weak economic performance in the first ten years reveals a necessary change in the philosophy of economic policy. The trade-off between short and long termed horizons of policy making had to be reversed. Now the time has come for much more attention to be paid to the structural changes needed to back sustainable economic growth.

First of all, policy measures should be promoted to improve international competitiveness of the economy. Fiscal adjustments should be aimed at stimulating savings and providing incentive for work. A good, real taxation system could encourage efficiency and savings. Savings in banks could be taxed moderately so as not to contribute to increasing interest rates.
Monetary policy has to remain tight until hard budget constraints operate, thus putting pressures on continuous adjustments in the real sector. Privatization has to be accelerated to spread widely top-quality management and reduce inefficiency in the economy. Restructured banks could help by pressuring for improved corporate governance in state-owned enterprises. The closing-down of losing-making enterprises should also be accelerated too, in order to reduce quasi-fiscal transactions and release resources for viable firms.

Talking about sustainable economic development, we also have to take into consideration the globalization process: as the degree of openness in the economy increases, markets will penalize any economically unjustified loosening of macroeconomic policies or any policy mistake. A small, open economy operates under external constraints and any change in the stance of macroeconomic policies is awarded or penalized in terms of capital movements.

Thus until hard budget constraints operate and enterprises are restructured, loosening monetary or budgetary policy could be imprudent. Positive results in economic growth would appear neither in the medium termed not even in the short term.

On the one hand, the resulting lower interest rates would allow granting of new credits for loss-making enterprises or for enterprises without outlets. Such increases in output are unsustainable. Low interest rates could also entail capital outflows, resulting in further currency depreciation. In the end, monetary policy would be tightened again, with higher costs in terms of lost credibility.

Instead of macroeconomic policy relaxation, globalization demands improve economic competitiveness. At the macroeconomic level we should avoid unsustainable fiscal deficits or an overvalued currency. But this is not possible without having strong businesses. With aspects of globalization being inevitable, Romanian firms have to improve their capability to
face ever increasing international competition. Industrial policies should play an important role here. We should not aim for protection that will be ever higher than the cost of liberalizing competition. In the absence of strong competitive firms, Romanian goods market will be invaded by foreign products with or without protectionism. Again, hard budget constraints are necessary for state-owned enterprises to base their output increases more or improved labor productivity, and to force them to keep the level of wages in line with productivity. In a full process of globalization, foreign direct investments are also a potential factor of economic growth. Unfortunately, in the case of Romania foreign investors need a more stable legal framework, to feel more confident that economic opportunities will emerge that would justify extending their operations within the country.

A new, much higher level of credibility can only be attained by also implementing a monetary policy based on market economy tools that secure smooth functioning of the credit transmission mechanism for the real economy. Reform should therefore address the factors stymieing the efficiency of monetary policy, such as the lack of competition in the banking sector, the still immature financial market, and non-performing loans.

Ongoing discussions with the IMF and the WB are focusing on fighting the mechanisms that triggered a perpetual waste of resources and stifled development of a profitable sector. Implementing the agreed measures would pave the way for the establishment, in the shortest period, of the critical mass for the transformation that should propel the efficient sectors and allow separation of inefficient ones. This would result in a reversal of the ratio between the efficient and inefficient sectors, with profitable, value-added-generating components taking the lead, while components relying structurally on either explicit or implicit subsidies should lose ground.