BULGARIA AND ROMANIA'S RELATIONS WITH THE *BRETTON WOODS INSTITUTIONS* AND THE EUROPEAN UNION (1990-2000)

History, Effects and Prospects

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More than a decade after the fall of communism, Bulgaria and Romania are still struggling to establish a competitive market economy and restructure the institutional framework accordingly. Although a lot has been accomplished in terms of structural reforms, the countries still have to address a number of problems in order to attain the major goals of sustainable economic development and, ultimately, accession to the European Union.

Lack of adequate political support for the reforms marked the initial years of reform for both countries. No substantial progress in structural reforms materialized in any of the countries until 1997. The inherent problems of transition coupled with long-delayed reforms and the adverse effects of the Yugoslav crisis resulted in low living standard and high poverty rates. The international institutions did provide the aid necessary to avoid major balance of payment crisis; of course, at the cost of further indebtedness. The vested interests of the old nomenklatura blocking the reform in the first years actually benefited the most from the foreign loans, as they used the funds primarily to alleviate the social pressure and enable them to stay in power for a longer period of time. From this perspective one could argue that in both countries the aid of the international institutions in the initial years of the post-communist period actually strengthened the position of a social section that was interested in maintaining the status quo, rather than reforming. This situation could not continue forever, as delaying privatization and subsidizing loss-making enterprises and banks led to a substantial deterioration in economic conditions. The ensuing social unrest brought about political change and momentum for reforms; only then could the countries really benefit from the financial and technical assistance provided by the international institutions to advance the necessary reforms. The role of the international institutions in the transformation of the social and economic systems of Bulgaria and Romania could not possibly be overestimated. The conditionality of IMF credits providing that drawing of installments be linked to performance criteria was the most powerful impetus for accelerating structural and banking sector reforms including privatization. In accession negotiations with the EU the governments were bound to »comply with the Stability and Growth Pact, to refrain from direct financing of the government deficit by the central bank, to prohibit privileged access by public authorities to financial institutions and to have liberalized capital movement.«[1] Reforms in a number of spheres of social life and the environment were undertaken as a result of the agreements reached during the accession negotiations.

It is important to analyze the history of the relations of the two countries in question and international institutions in order to extract the lessons they contain. Important questions that could find answers in such a retrospective overview, such as whether the international institutions policies in the first years of transition could be designed more effectively in view of the political situation; whether the conditionality of the agreement with international institutions lays enough emphasis on creating conditions for attracting FDI and so forth. Perhaps all debatable issues can be summed up in one big question: Is there anything that could be done differently in order to make the transformation in the two states more effective and minimize the associated human cost? The answer(s) to this question could help to structure future assistance strategies to the two countries in a way that best serves the goals of achieving sustainable economic development and eventual integration into international institutions.

Bulgaria: Principal Political and Economic Developments since 1990
Political Developments

In November 1989 Todor Zhivkov, the head of the *Bulgarian Communist Party* since 1954 was forced to resign. His place was taken by the then former foreign minister Petur Mladenov, noted for disapproving some of Zhivkov's policies, especially the internationally condemned repressions against the Turks in the period 1984-1989. Mladenov called for the first free elections to be scheduled for June 1990. *The Bulgarian Socialist Party* (*the Bulgarian Communist Party* that had changed its name two months earlier in April) won 47% of the vote. *The Union of Democratic Forces* (formed in December 1989 out of the leading opposition groups) gained 38%. The UDF refused to participate in a coalition government, claiming that the BSP's electoral victory was secured through manipulation and unequal access to the media. In August 1990 the leader of UDF

1 Partnership for the Accession of Bulgaria. In: http://www.eu.org.

was elected President of Bulgaria. The economic situation had worsen substantially at the time, leading to rationing of basic foods. Major demonstrations and strikes followed, forcing the BSP government to resign. In the October 1991 parliamentary elections the UDF acquired 34% of the votes, 33,1% went to the BSP. The movement for *Rights and Freedoms* (representing the Turkish minority) in effect was placed in a controlling position – its choice for a coalition partner determined which party was to form the government.[2] For eleven months the UDF and the MFR led the country in a coalition government, then in October 1992 the MFR leaders chose to change »partners« and form a coalition with BSP. Consequently, the by the BSP dominated governments were in charge until the end of 1996. In the period February 1997- April 2001, a UDF government has ruled the country.

Economic Developments

1. The Legacy

From the communist regime Bulgaria inherited one of the highest debt levels amounting to 140% of GDP in 1991.[3] The adverse impact from the dissolution of COMECON affected Bulgaria more than any other country; as the USSR share in Bulgarian trade was higher than any other COMECON member. Consequently many enterprises geared to the Soviet market were completely inadequate for the new conditions.[4]

2. The Policies

The policies conducted by the former communist party in the first seven years of transition (with the exception of 11 months in 1991-1992) were devastating for the economy. The policies adopted by the two successive BSP governments in the period 1992-1997 combined blocking reforms with draining what was left of the country's resources, which were channeled in two main directions. First, populist economic measures were adopted in order to secure the votes necessary for maintaining the dominant position of the BSP. »The BSP governments of Berov and Videnov poured billions of leva into faltering state-owned enterprises.«[5] Secondly, the groups with vested interests reaped incalculable profits by virtue of their controlling positions in the economy. Obtaining loans from the state-owned banks without adequate guarantees was one of the mechanisms used. The »entrance-exit« scheme in which the manager is able to pur-chase supplies or sell products at a price different from the market one and pockets the difference provided another widely exploited opportunity for profiting cliques while the state had to bear the losses. These practices could take place only in the framework of a ruinous macro-economic policy.

> When high interest rates became unsustainable because they triggered an increase in the domestic debt, the Central Bank had then to finance the fiscal deficit, which it did through monetization, provoking an increase in inflation in 1996. This in turn eroded the confidence of the public, which began to withdraw its deposits from the commercial banks.[6]

All this prepared the ground for the 1996 crisis in which »there occurred a 10% drop in GDP, inflation exceeded 300 percent and the budget deficit soared to 13 percent of GDP.«[7]

For all its negative impact, the crisis did achieve a major gain for the country: the economic situation was so disastrous, that the overwhelming majority of the electorate was convinced of the failure of the policies adopted by the BSP and for a need for a change in leadership. The new UDF government elected in 1997 could count on popular support to implement the much-delayed changes by introducing a currency board supported by IMF, speeding up the structural reform through privatization and bank reform.

Thus the real efforts towards reforming the economy started in 1997. They were hampered by a legacy of economic crisis and burdened by the external shocks of the Yugoslav crisis (the Bulgarian foreign minister Nadejda Mihajlova claims the country lost $ 6 billion due to the Yugoslav crisis[8]). Nevertheless the government's reform efforts were rewarded by lasting stabilization, an increase in foreign aid and the recognition of the international community.

Of course, living standard and GDP per capita remained low, a natural consequence of both communist and former communist government in the past. This fact only increases the value of the UDF government reform efforts. Of course the UDF's policy also has its flows. »[Privatisation]

2 Holmes, Leslie: Postcommunism. An Introduction. Durham: Duke UP 1997, pp. 87-90, p. 157 (table).

3 Lavigne, Marie: The Economics of Transition. London: Macmillan Pr. [2]1998, p. 141.

4 Ibid.

5 Ganev, Venelin: Bulgaria's Symphony of Hope. In: Journal of Democracy. Vol. 8, no. 4 (October 1997), pp. 125-137.

6 Lavigne 1998, p. 141.

7 Ibid.

8 Fresh Hope for Bulgaria. In: The Economist v. 26.10.2000.

was marked by a large number of insider deals which have prompted allegations for corruption [...] red tape, corruption and administrative inefficiencies as important obstacles for doing business.«[9] However, in the light of the legacy this government inherited the changes that did take place are indeed impressive. The challenge is now to continue the prudent policies implemented so far by securing adequate political support.

9 Fisher, Stanley: The Lessons of Reform – Ten Years On. Sofia: Univ. for National and World Economy. Presentation, May 25, 2000. Publ. in: www.imf.org (Bulgaria and the IMF) .

Bulgaria and the IMF

Clearly two phases can be delineated in the relations of Bulgaria with the IMF, the line between the two being drawn with the change of government in August 1997. The BSP governments were characterized by a total disregard of the IMF's policy recommendations. Bulgaria is a member country since 1991; however prior to 1997 the »give and take« with the IMF had financial rather than policy-determining character: »over the last four years (1993-1997) not a single policy proposal sponsored by IMF has been implemented in Bulgaria.«[10] Despite this »reluctance« on the part of the government to reform, it still obtained credits from the IMF in all the years except 1995.[11] Regarding the reform therefore these initial credits did more harm than good, as they supported the efforts of the anti-reform former communist government to make ends meet while continuing to strip the country of what was left of its assets. In fact the refusal of IMF to extend credit in 1995 (as the government refused to accept a *Currency Board Arrangement*) helped trigger the crisis that eventually led to a government change and pro-reform government election.

The aid provided by IMF since 1997 could not be overestimated: »[B]y 1997 Bulgaria had undergone several stabilization attempts under a flexible exchange rate regime and the introduction of CBA (Currency Board Arrangement) was instrumental in stopping the vicious cycle.«[12] The lev was pegged to the DM and the government's ability to deficit financing was curbed abruptly. Macro-economic stabilization followed soon. The IMF demands for speeding up privatization and restructuring were largely met by the year 2000, with the exception of the energy sector where reforms are underway. Of course, the social costs of reforms are very high, especially given the fact that it was delayed for a little less than a decade. In 2000 unemployment peaked, reaching a record height of 19%.[13] Assistance is provided by both IMF and the *World Bank* to mitigate the negative social effects of the reform. Overall, the assistance of IMF in terms of both financing and expertise has been crucial for implementing the first substantial economic reform in the country for the post-Cold War period. For the period 1997-2000 the *Fund's* total commitment approximated SDR 1 billion.[14]

10 Ganev 1997, p. 132.

11 Country Info Bulgaria: Summary of Disbursement and Repayments. In: http://www.imf.org.

12 Gulde, Anne-Marie/ Kahkönen, Juha/ Keller, Peter: Pros and Cons of CBAs in the Lead-up to EU Accession and Participation in the Euro Zone. In: IMF Staff Papers (January 2000).

13 Fisher2000.

14 Country Info Bulgaria: Summary of Distribution and Repayments. In: http://www.imf.org.

Bulgaria and the *World Bank*

Bulgaria joined the *World Bank* in 1990, whose funds were aimed at investing in physical and social sector infrastructure. The *World Bank's* lending to Bulgaria is delivered though 23 operations for the total value of USD 1,44 billion, including adjustment operations (USD 850,8 mio.), investment loans (850 mio.) and a *Bank-managed Global Environment Facility* (GEF) grant for USD 9,9 mio. The infrastructure projects continue to hold the biggest share of the active portfolio: 78% all approved prior to 1996. Recently there is a shift in priorities toward the social sector, now comprising 17% of all commitments in operations.[15]

15 Country Brief: Bulgaria. In: http://www.worldbank.org.

Overall Framework for EU Integration

In practical terms the accession of Bulgaria and Romania was made possible at the *Copenhagen European Council* of 1993, which confirmed the legitimacy of Central and Eastern European applications for membership. During this council the membership criteria the applicants need to meet before they join were defined to include:

- the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities (political criterion)
- the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the European Union (economic criterion);
- the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union (criterion concerning the adoption of the Community acquis).[16]

16 Enlargement: Preparing for Accession. In: http://europa.eu.int/index-en.htm.

In December 1999 the *Helsinki European Council* decided that the thirteen applicant countries participate on equal footing. An important step toward the integration of the applicant countries was taken with the signing of the *Association Agreements* (also known as *Europe Agreements*). They provide the legal framework for association between the applicant countries and the EU and cover their political and economic relations. The immediate objective of the *Association Agreements* is to establish a free trade area by 2002 liberalizing trade and industrial products.

For all applicant countries, launching the *Accession Partnerships* on March 15, 1998 provided a single framework bringing together all forms of assistance and assessing compliance with the terms applying to this aid (obligations under the *Europe Agreements* and progress toward meeting the Copenhagen membership criteria).[17]

The reports analyzing the progress made by each of the candidates by the end of the year 2000 indicate that all countries except Turkey fulfill the political criteria for accession while only Cyprus and Malta fully meet the economic criteria. Regarding adoption of the acquis the countries' position varies. Bulgaria is considered unable to comply with the adoption of the acquis in the medium term.[18]

The aid for supporting the pre-accession process was channeled through the *PHARE* program aiding investment financing (70% of the aid) and institution building (30%). Separately aid for agricultural development and structural aid used to help applying countries to comply with Community standards in transportation and environment were distributed.

Adopting the *Stability Pact for SEE* in June 1999 provided a forum for coordinating the efforts of international community toward »creating the conditions, for countries of SEE, for full integration into political, economic and security structures of their choice«.[19]

The *European Community's Financial Regulations* requires the commission to approve all contracts financed under PHARE before they enter into force. Financial aid for agricultural and rural development (Sapard) and a structural instrument (ISPA) were added to the assistance instruments from 2000. These assistance instruments give priority to transport and environmental issues. The aid for the period 2000-2002 will be in sum between EUR 706 mio. and EUR 831 mio.

Strengthening the administrative capacities of the applicant countries to implement and enforce the acquis is also enhanced by t w i n n i n g: long-term secondment of civil servants from EU member states. For Bulgaria, 10 projects in the agricultural, environmental and financial sectors have so far been twinned under PHARE.

17 Ibid.

18 Agenda 2000 assessment, publ. 1997.

19 Principles and Norms. In: http://www.stabilitypact.org.

Bulgaria and the EU

> For many countries, the prospect of joining the European Union has been a powerful spur to reform.[20]

This conclusion advocated by Fisher and Satnay can be illustrated by the relations of Bulgaria with the EU in the last decade. Bulgaria signed an *Association Agreement* on March 1, 1993 and submitted an accession application on December 14, 1995.

The impact of PHARE in facilitating Bulgaria's transformation had been profound. It aided the mass privatization completed in 1997, the establishment of private credit associations lending to private farmers, and providing social assistance in the 1996/67 crisis when 25% of the poorest households received PHARE support. PHARE funds for Bulgaria total EUR 865,5 mio. in the period 1989-1999. EUR 30 mio. were allocated for a cross-boarder cooperation program including Romania. Another EUR 14 mio. will be granted from the catch-up facilities to support projects aimed at creating jobs and promoting foreign direct investment.[21]

Generally, as regards Bulgaria and Romania, the PHARE aid exhibits to a lesser extent the trend of support for reform-blocking regimes in the beginning of transition that applies to aid from financial institutions. Of course the aid is not tied directly to reforms. This is illustrated by the fact that despite the initial dissatisfaction with pace of reforms the EU aid for Bulgaria was not halted. In 1997 *Opinion on Bulgaria*, the *Commission* stated that: »The current improvement in Bulgaria, following the arrival in power of a new government, indicates that Bulgaria is on its way to satisfy the political criteria.« The general evaluation in 1998 indicates that »important first steps have been taken in general public administration reform.«[22] Thus despite the fact that by 1997 Bulgaria still did not fulfill even the political criterion, it received EU funds. This trend is bound to continue in the future: »During the period 2000-2006, pre-accession aid to the candidate countries will be more than doubled.«[23]

20 Fisher, Stanley/ Sahay, Ratna: The Transition Economies After 10 Years. IMF Staff Papers, Feb. 10, 2000. In: http://www.imf.org.

21 European Commission (1999): Regular Report from the Commission on Bulgaria's Progress Toward Accession. In: http://europa.eu.int/comm/enlargement/bulgaria/rep_10_99/index.htm

22 Regular Report 1998, p. 46.

23 Regular Report 1999.

24 Regular Report 1999.

25 IP/00/1264 Brussels. Nov. 8, 2000. *A new momentum for enlargement.*

However, EU aid is centered on specific projects which abates the opportunity for misuse of the funds. In addition, the EU funds committed in the initial 6/7 years of reform for both countries is significantly smaller than that committed by the financial institutions. The amount of aid is not directly proportional to reforms accomplished, but due to the targeting of the aid it provides incentives for the development of infrastructure and SMEs and strengthening institutional capacity. In this way it helps building the framework indispensable for the proper functioning of a market economy.

A positive trend in Bulgarian-EU relations is the steady increase in the share of EU in Bulgarian's overall foreign trade in last years from 44,7% of exports in 1997 to 50,6% in 1998 and 60,3% in first quarter of 1999); share of EU in imports rose from 38,7 (1997) to 49% (1998) to 49,3% for the first quarter of 1999.[24]

A favorable recent development in Bulgarian-EU relations is the Dec. 1, 2000 decision of the *Councils of Ministers of Home Affairs and Justice* to start a procedure that, if successful, would result in lifting the visa requirement for Bulgarian citizens in year 2001. At this occasion the Bulgarian president Stoyanov declared: »For the Bulgarians the Berlin Wall fell today.«

At the *Nice European Council Meeting* (Dec. 7-9 2000), it was decided that negotiations should be speeded up even further. For Bulgaria and Romania, this meant proposing 2007 as a tentative year for accession and defining the number of seats in the *European Parliament* that would be allocated to the two countries upon accession. In addition, one month prior to the *Nice European Council Meeting* the *Commision* proposed that the negotiations on the remaining issues be accelerated:

- On the basis of the progress made to date, the Commission considers that the time has come to outline a strategy to take the negotiations into a more substantial phase and point the way towards their conclusion. For this purpose, the Commission: [...] proposes a modified method for the opening of negotiations on the remaining chapters with the candidates with whom negotiations were opened in 2000 (Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia) allowing to open these chapters more rapidly, in line with the European Council conclusions of Santa Maria da Feira.[25]

26 Holmes 1997, p. 83.

Romania: Principal Political and Economic Developments since 1990
Political developments
The Legacy

From 1965 to the end of 1989 Romania was ruled by Nicolae Causescu. His regime was characterized by dictatorial centralization of power coupled with a personality cult and pervasive nepotism, labeled sometimes »socialism in one family«. Official nationalism and repression against the Hungarian minority intensified as the economic situation deteriorated. By the late 80's the living standards of the population were extremely low. There has been rationing of both food and energy as part of Causescu's policy toward elimination of Romania's foreign debt. In 1989 the military had turned against him allegedly over the dubious circumstances around the death of the defense minister who had refused to order his troops to fire on the demonstrators.

The 1989 Romanian revolution was the most violent of all changes of regime in the post-communist countries. Both Causescu and his wife were executed and further executions between 689 and 1033 were reported.[26]

Political Developments since 1990

In view of the oppressive nature of the preceding regime one could expect the absence of organized opposition. The *Communist* apparatchiks were able, like in Bulgaria, to capture the most important positions of power. The successor party to take the lead after the December 1989 revolution – the *National Salvation Front* (NSF) pledged a break with communism but employed all of the communist party methods of control to enhance its position: government controlled television and secret police, uneven access to financial resources in the pre-election campaign. In addition, the President of NSF, then 65-year-old former *Communist Party* functionary Ion Iliescu was able to build on the communist-era propaganda by positioning his party as a guardian against »selling the country« to Westerners and deteriorating the population's position by quick pro-market reforms. Thus both in the elections of 1990 and 1992 Iliescu's party (named initially NSF then *Democratic NSF*) won the majority of votes. As regards the 1992 elections:

> Together with the nationalist parties, the DNSF (now PSDR) represented almost half of the Romania's voting population: in other words, almost half of the Romanians perceived sweeping reforms as more threatening than a continuation of Iliescu's inefficient regime. This hostility to radical privatization and flirtation with chauvinistic parties was the main strategy pursued by Nicolae Vicariou prior to 1995. In 1995, the private sector share of industrial production was only about 12 percent.[27]

The rise of independent media and the proliferation of NGOs with the ability to criticize the regime and expose corruption were crucial for the first opposition victory in the 1996 elections. The CDR (*Democratic Convention of Romania*), a center-right alliance, obtained the majority of votes and formed a government under Victor Ciorbea. The 1996 elections did constitute a major development, but the effectiveness of the government and the continuity of its policies were hampered by fragmentation and controversies among the constituent parties. For the period 1996-1999 the country changed three governments and four prime ministers. When the reforms were expedited under pressure from the international financial institutions, the negative social consequences brought about a backlash against the reformist parties. Iliescu's propaganda, blaming the reformers for all the problems of the country and upholding nationalism, capitalized on the stereotypes inherited from Causescu's despotic regime.

> Iliescu's strategy was to cater precisely to the fears, neuroses and phobias among Romania's industrial workers, peasants in the less-developed regions and retired population.[28]

Since these sections comprise a significant percentage of the population and because of the fragmentation of the opposition, Iliescu continues to play an important role in Romanian politics. Contrary to the opinions of many analysts who hailed the end of Iliescu era with the 1996 elections, Iliescu's party (PDSR) won the November 2000 elections. An even bigger surprise from these elections was the fact that the openly nationalistic *Romania Mare Party* (PRM) of Corneliu Vadim Tudor came out second. Tudor, an ethnocentric leftist radical, was one of the court writers of Causescu who never, unlike others in the same position, renounced his behavior under the former regime as caused by oppression. His party was considered a marginal grouping; in the 1992 elections it seized only 3,9% of the votes for the *Senate*.[29]

A variety of social, political and demographic factors can be used to explain the overcome of the 2000 elections post factum. The reality of the situation is that the Romanian political scene is still dominated by figures from the Communist era who had previously hampered democratization and integration with EURO-Atlantic structures. Nevertheless, Iliescu announced that integration into the European Union and NATO is a priority of his political program and his government would cooperate closely with the IMF and the *World Bank*. In adition, since the new cabinet needs the support of the *Democratic Alliance of Hungarians in Romania* (UDMR), it is expected to abandon the previous association with chauvinistic forces and ideas.

Economic Developments

Causescu's despotic regime bequeathed a dismal heritage: an industry burned by loss-making enterprises, a society suppressed and manipulated for decades by means of pervasive propaganda and KGB-like secret services.

For all its vice, Causescu did leave one positive asset to Romania – clearing its external financial obligations. While all other post communist countries were burdened by high foreign debt levels, Romania was able to start the transition process without this constraint. This advantage was gained at the cost of what was one of the lowest living standards in Eastern Europe and prolonged sacrifices such as rationing of foodstuffs, electricity cuts, etc. The Romanian people however, did not feel any substantial reward from the sacrifices imposed during the communist regime. The former communist party in charge of the government until 1996 engaged in heavy borrowing from the IFIs coupled with populist polices hampering reforms and reluctance to close the loss-making companies. The opposition governments in power after 1996 were forced to continue borrowing in order to back restructuring and meet the obligations of the loans already incurred. The outstanding external debt of Romania increased drastically from 2 479 mio. USD

27 Tismaneanu, Vladimir: Romanian Exceptionalism? In: Davisha, K./ Parrot, B. (Eds.): Politics, Power and the Struggle for Democracy in South-East Europe. Cambridge: Cambridge UP 1997, p. 424.

28 Ibid., p. 426.

29 Ibid., p. 423.

in 1992 to 8 823 mio. USD in 1997.[30] In year 2000 the external debt/GDP ratio was estimated by IMF at 41%,[31] the gross external debt peaking at 12 billion USD. The *World Bank* commitments account for over USD 3 billion since 1991.[32] In terms of the external debt/GDP ratio the position of the country is not so bad; in comparison, Bulgaria had a ratio of 79,8% for 1999.[33] The level of GDP per capita is also similar to that of Bulgaria: it equaled USD 1440 for 1999. However the deterioration in living standards and the social cost of closing down enterprises is bound to increase steadily in Romania due to the delay in reforms. The situation is complicated even further by the election 2000 results: the reformed communist party won the majority, followed by the ultra-nationalist *Greater Romania Party*. This development is expected to have a negative impact on the badly needed FDI.

The transition process in Romania resembled that of Bulgaria in that two major phases can be observed. The first is associated with the rule of former communist parties in the period 1990-1996 and is characterized by inefficient fiscal policies and slow pace of privatization. Comparing the various aspects of transition in the period 1990-2000, Romania is either at the same level with Bulgaria or lagging behind. As regards the period 1990-1994:[34]

	Bulgaria	**Romania**
Privatization		
Restitution	Yes (1991-land 1992 either assets)	Limited (laws of 1991 and 1994)
Small Privatization	Slow Start in 1992	Slow Start 1993
Large-scale Privatization	Law 1992, voucher scheme in 1994	Begins in 1994
Macro Stabilization Program Starts	Feb. 1, 1991, later stopped Genuine schock therapy introduced 1997	Nov. 1, 1990 stalled later New program launched 1997

The second period 1997-2000 is characterized by accelerating reforms for both countries launched by opposition governments. In Romania rapid privatization and closure of loss-makers took place at the cost of higher poverty rates and unemployment, contributing to the electoral defeat of the opposition in November 2000. Since the former communist party in charge 1990-1996 had adopted populist economic measures including subsidizing loss-makers, the opposition engaged in the unpopular but extremely necessary reforms at the cost of an electoral defeat. Still, while the »window of opportunity« was open major reforms were introduced. There were more privatization deals in 1999 than in the previous 8 years.[35] In 2000 the private sector accounts of 60% of GDP. By 2000 more than 25% of large-scale enterprise assets were privatized and nearly comprehensive program was implemented for small-scale enterprises privatization. Romania now faces debt repayment problems which oblige the government to listen to IMF and *World Bank* policy advice. The biggest menace for the future is coming from the re-election of the former communist party (currently called PDSR). This could place the country back in phase I »stalled reforms«, while the foreign debt continues to increase. Hopefully the IFIs would adopt stricter lending policies and prevent further political blockage of reforms.

> Close to this very influential network of former apparatchiks who enjoyed the personal protection of the former president [sc. Iliescu – the head of PDSR – the winner of 2000 elections, LP], are the »government's« businessmen. They are businessmen who make their future by taking preferential loans and credits from state-run banks and who were the main sponsors of the government's and Iliescu's election campaigns. They are the »the state capitalists« [...] These different groups share a common interest in a strong state. The bureaucrats want to defend the state in order to ensure their survival; the

30 IMF Romania Statistical Appendix. In: http://www.imf.org/external/pubs/ft/src/1098/cr98123.pdf.

31 Press Release _ 99/38, August 5, 1999. IMF Approves Stand-By Credit for Romania. In: http://www.imf.org.

32 Country Brief: Romania. In: http://www.worldbank.org.

33 European Commission (2000): Report on Bulgaria. In: http://europa.eu.int/comm/enlargement/dwn/report_11_00/pdf/en/bg_en.pdf.

34 Lavigne [2]1998, p. 123.

35 Country Brief: Romania. In: http://www.worldbank.org.

now »capitalists« want to keep monopolies and avoid real competition through a sort of state-favored company status; and the entrepreneurial politicians need slow; state-controlled privatization in order to make their fortunes.«[36]

36 Pippidi, Alina Mungiu: Romania: From Procedural Democracy to European Integration. In: Kaldor, Mary/ Veivoda, Ivan (Eds.): Democratization in Central and Eastern Europe. London: Pinter 1999, p. 143.

37 Country Brief: Romania. In: http://www.worldbank.org.

38 Press Release _ 99/38, August 5, 1999. IMF Approves Stand-By Credit for Romania. In: http://www.imf.org.

39 Lavigne ²1998, p. 249.

40 Country Brief: Romania. In: http://www.worldbank.org .

Romania and the IMF

The slow pace of reforms endorsed by the government caused three *Stand-By Programs* (SBA) with the IMF to go off-track in the period 1991-1996. In February 1997 with the change of government the previous year the reforms accelerated by debt repayment problems and a decline in FDI (among other factors) led to a deteriorated economic situation. Rating agencies downgraded Romania's credit standing; by late 1997 the SBA went off-track.[37]

On August 5, 1999 the IMF approved the next SBA for Romania to support the government's stabilization and reform program.

> Directors urged the authorities to hold firm to their policy commitments as this is essential for regaining market confidence [...] and cautioned against a premature relaxation of fiscal policies [...] Directors welcomed the enterprise and bank restructuring program agreed with the World Bank and urged that it be implemented vigorously[.][38]

Since without the IMF loans the Romanian government could not meet an external debt servicing of USD 3 billion in 1999, implementing the *Fund's* recommendations was an essential feature of the governmental policy. Thus, the IMF involvement was a crucial factor in accelerating structural reforms and adhering to more restrictive fiscal policies. In addition, the 1999 IMF policy demonstrated a laudable sensitivity to the socio-political situation of the country:

> Unemployment benefits, severance payments and pensions, however, are not targeted to decline in real terms, reflecting concerns about the country's delicate social and political balance.[39]

The involvement of IMF in the initial years of reform could not contribute substantially to transition efforts due to the government's anti-reform orientation. In effect it could be argued that in the first six years in both Romania and Bulgaria the funds extended by the IMF actually hampered reform:

> The seal of approval by the IMF usually triggers agreements with other IFIs; inflow of private capital and the conclusion of debt negotiations with official creditors in the framework of the Paris Club or with banks in the framework of London Club.[40]

Both Romania and Bulgaria received this »seal of approval« prior to 1997 without implementing major reform policies. In Romania the heavy borrowing that helped the vested interest groups stay in power through spending the drastically increased foreign loans on populist policies detrimental for the economy for electoral benefits. Thus the IMF actually aided anti-reform governments to stay in power and impede transformation in the first years.

Of course this situation changed with the *Stand-By Agreements* (SBAs) of 1997 and 1999 which employed both the funds and the expertise of the *Fund* in the form of policy advice for accelerating the reform. IMF's policy for Romania after 1996 was thus instrumental for accelerating reforms.

Since in November 2000 the reformed communist party was reelected perhaps the IMF should reconsider providing a »seal of approval« if commitment to a continuation of reform is not present.

41 Ibid.

Romania and the *World Bank*

Since 1991, the *World Bank* commitments to Romania total over USD 3 bio., used to finance a portfolio of 29 IBRD projects. The bulk of this amount was distributed prior to 1997. The bank's project target strengthening social safety net, health, education and rural development and structural reforms. The EU-accession related programs have priority.

In 1999 the Bank committed USD 325 mio. to support the government's stabilization efforts (accelerated privatization) and abating the ensuing social problems and instability.[41]

The criticism that could be addressed to IMF's policies applies to the policies of the Bank as well. While the timely response to the social problems associated with the reforms is indeed laudable, the heavy lending in the period of 1991-1996 did not translate into development.

42 Enlargement: Preparing for Accession. In: http://europa.eu.int/index-en.htm.

43 Regular Report from the Commission on Romanian's Progress toward Accession – November 1998. In: http://europa.eu.int/comm/enlargement/romania/index.htm.

44 Ibid.

Romania and the EU

An *Association Agreement* was signed with Romania on Februar 8, 1993. An accession application was submitted on June 22, 1995.[42] A specific *Accession Partnership* was adopted, as is the case with the other applicant countries, in 1998. In March 1999 Romania presented its first *National Program for the Adoption of the Acquis* (NPAA).

In 1997 Romania did not meet any of the Copenhagen criteria. However, the 1997 *Opinion of the Commission* stated that: »The current improvement in Romania, following the arrival in power of new government indicates that Romania is on its way to satisfy the political criteria.«[43] Trade volume with the EU increased significantly; the EU accounting in 1997 for 56% of Romanian exports and 52% of imports.[44] As part of the trade provision of the *Europe Agreement* Romania has reduced a number of tariffs and eliminated the Community's textile import restrictions.

The 1998 *Commission Report* concluded that Romania fulfils the Copenhagen political criteria, however it also emphasized that Romania has made very little progress in the creation of market economy and its capacity to cope with competitive pressure deteriorated. In 1999 the report affirmed the position that Romania fulfils the political criteria although a provision was made that this status could be re-examined if the authorities did not handle adequately the crisis in the child care institutions. The 2000 report gave an overall positive assessment of the situation by judging that the 1999 short term accession priorities have been met.

So far progress has been made in adoption of new legislation (for example, a law on the civil service, a new law on state aid control and in legislative alignment in the transport sector). The 1999 report notes progress has been made in justice and border management. The 2000 report marks progress in addressing the problems of institutionalized children by adopting a national strategy and transferring funds from the budget. The agreements achieved with IFIs were also noted as significant positive developments by the reports.

The major impediment to progress pointed out in the reports is in the field of economic development and institutional capacity. That Romania has not substantially improved its economic prospects was attributed to the fact that many institutions required to ensure the functioning of a market economy do not exist or are too weak. The uneven commitment to reforms and uncertain legal framework continue to hinder development. The demilitarization of police needs further efforts as well as changing the tradition of the government to rule by ordinances. Further progress is needed in reducing the levels of corruption.

45 Relations Between the EU and Romania. In: http://europa.eu.int.

46 Ibid.

Pre-accession Aid: PHARE

During the period 1990-1999 EURO 1 203 billion were allocated to Romania under the PHARE program.[45] Under PHARE, know-how and financing had been delivered to facilitate restructuring, privatization, SME, trade, investment, energy, land registration, etc. PHARE co-financed major infrastructure projects financed by EIB/EBRO including the modernization of *Romania Railways*, roads rehabilitation; the development of the port of Constanta and the *Municipal Development Program* in 15 cities. As a response to flood damage in 1997/1998 PHARE supported 150 rehabilitation projects (average value EURO 200 000). Resources have been provided in the form of small loans or grants to stimulate local economic development and job creation. In Jeu valley, an area with substantial unemployment, 750 permanent jobs were created through grants to small business totaling EURO 830 000.

Twinning in Romania includes 16 projects, such as building capacity in the phytosanitary sector, policy reform in the *Ministry of Agriculture*, water management, development of local environmental protection agencies, creating a department for internal financial control drawing up a development program for the National Bank, approximation of legislation and organization of courts; projects fighting corruption and organized crime.[46]

The most recent development in Romania-EU relations is the *Council of Ministers'* decision to remove Romania, like Bulgaria, from the negative visa list. Although the actual implementation of this decision is not yet scheduled this is a major step forward for Romania on the way to European integration. The progress achieved by Romania in reforms is considered insufficient in most of the reports presented annually by the *Comission*, although advances made in recent years are taken into consideration. The decisions reached at Nice provide Romania, as all the other »second wave« candidates, with the opportunity to catch-up for accession in 2007. Whether the country will manage to take advantage of the opportunities that lay ahead now more than ever depends on the policies adopted by the future governments.

Conclusions

Overall, the fact that Romania and Bulgaria are preparing for EU accession (even though in the second round), has had a very positive impact. This especially since the accession negotiations were formerly launched in 1998, providing a national program of reform priorities that is evaluated by the *Commission* each year and new goals are set. The EU has an indispensable role in helping the candidate countries on their way to build consolidated democracy and a functioning market economy. It is in the unique position of being the only international institution that helps and monitors reforms in all spheres of society. While the IMF's priority is macroeconomic stabilization and the *World Bank* finances specific projects, the EU efforts target comprehensive reform that extends from legislature alignment to minority integration and programs for institutionalized children. In other word, it is the unique role of EU to promote the Western values in all domains of public life. The initiative of twinning is also a unique process associated with the preparation for EU accession that has helped in the transfer of know-how in institution building.

In the process of transformation, the two countries have received assistance from various IFIs: IMF, the *World Bank*, EIB, EBRD. The arrangements achieved between the candidate countries and the IFIs were regarded by the *European Commission* as an important prerequisite for meeting some of the *Accession Partnership's* priorities. The efforts of the various international institutions to aid development in the countries in question was coordinated at a number of levels: projects were co-financed by several institutions, the *World Bank* gives priority to EU-accession related projects; adopting *Stability Pact for SEE* in June 1999 provided an official forum for coordinating the efforts if the international community.

In the initial stage of transition when the two countries were still governed by (more or less) reformed communist parties, the IFIs' policies hindered rather than facilitated reforms. Both countries were characterized by the domination of economic activity of vested interest groups, closely related to the ruling parties.

> Before this [sc. 1997, LP], Bulgaria was considered the best example in transition countries outside the CIS of the capture of policy by strong vested interests [...] the activities of powerful economic vested interests are undermining attempts to continue the reform process.[47]

If Bulgaria prior to 1997 can be classified as the best example for a capture of society by vested interests then Romania is certainly one of the top contenders for this »honor«. Actually, if the pace of reforms and the extent of corruption are taken into account, Romania did and still does qualify for the »top« position. For example by 1999 EBRD estimates the percentage of firms that bribe frequently or more at 50,9% for Romania, as compared with the modest 23,9% in Bulgaria. In any case, both countries were governed by anti-reform political forces prior to respectively 1996 and 1997; these groups created an environment in which rent-seeking behaviour and criminal activities expanded fast. Moreover, they employed populist soft budget policies that led to a sharp increase of the economic problems. IFIs lending to Bulgaria and Romania in this period, de facto supported the ruinous policies of these »interest groups«. It helped them conduct populist measures which ensured their electoral success despite the fact that they were consistently leading the countries into a crisis. In the case of Romania heavy borrowing from IFIs not only did not help in reforms or development, but also led to foreign debt levels the country is hardly able to service (in 1992 Romania had a foreign debt of approximately USD 2 billion, as opposed around 12 billion in 2000). EU assistance was quantitatively smaller and centered on infrastructure projects, so its impact in this respect can not compare with that of the other IFIs. The IMF's role in this connection was crucial, since »the seal of approval of IMF usually triggers agreement with other IFIs«.[48] Since IMF had three *Stand-By Agreements* in the period 1991-1996, it gave this »seal of approval« three times. Despite the fact that all three SBA went off-track the foreign debt of Romania nearly quadrupled in this period.

However, the IFI's assistance to both countries had been crucial for expediting reforms in the period 1997-present for Bulgaria and 1996-present for

47 Havrylyshyn, Oleh/ Odling-Smee, John: Political Economy of Stalled Reforms. In: IMF Staff paper. http://www.imf.org.

48 Lavigne[2]1998, p. 249.

Romania. The *Currency Board Arrangement* (CBA) established in Bulgaria in 1997 »was instrumental in stopping the vicious circle […] created stability and thus contributed to faster reductions in inflation, […] supported solid growth.«[49] The impact of CBA in Bulgaria was assessed as very positive by several IMF experts, to the extent that they recommended maintaining this arrangement until EU accession becomes a fact.[50] In Romania also tightened fiscal policies were introduced under IMF pressure and privatization was accelerated (there were more privatizations in 1999 than in the last eight years). Overall, at present the progress made by Romania is considered slower as compared to that of the other candidates for accession to the EU. The latest *IMF Staff Country Report* (Dec. 2000) notes the »hesitant and weakly implemented approach to structural reform and a stop-and-go pattern of economic policies«.[51] Bulgaria's policies in the initial years of reform reflected similar flows. However, subsequently to 1997 the policies pursued by the government were evaluated as overally prudent and consistent both by the EU annual reports and by the IFI's analyses. A recent *World Bank* briefing commented that »[s]olid growth rates and increasing success at attracting foreign direct investment (FDI) in recent years have positioned Bulgaria to become Southeast Europe's business portal.«[52]

49 Gulde/ Kahkönen/ Keller 2000.

50 Ibid.

51 International Monetary Fund, December 2000. IMF Staff Country Report No. 159 (2000).

52 IPAnet briefing: Growth and Investment Transform Bulgaria into a Regional Standout. In: http://www.ipanet.net/documents/worldbank/databases/ipabrief/special/bulgaria.htm.

The Future

2000 was an election year for Romania; the reformed communist party of Ion Iliescu was reelected, after four years in opposition. Iliescu is the new president of Romania, elected with nearly 70% majority. The second political power in parliament is the nationalistic *Greater Romania Party* led by Vadim Tudor: a former court-writer during the communist period. The Iliescu government avowed integration in EU and NATO would be among the priorities of its mandate; further promises were made to maintain close cooperation with the IMF and the *World Bank*.

2001 is an election year for Bulgaria; it is difficult to forecast the outcome of the coming elections since in the polls the difference between the currently ruling *Union of Democratic Forces* (UDF) and the reformed communist *Bulgarian Socialist Party* is 3-4%. Even if UDF is the winner of the forthcoming elections, the odds are that it will not be able to secure the majority and will have to form a coalition government. An interesting development in Bulgarian public life is expected in spring 2001: Tsar Simeon II is expected to return in the country permanently and enter the political scene. In any event, parties from the whole political spectrum had publicly pledged determination to continue reforms and work toward integration into the European Union.

What will be the consequences of these developments for Bulgaria and Romania? The positive scenario would include a continuation of the reforms that took place in the last 3/4 years. If the reformed communist parties return to power as social democrats, we could expect further progress in transition. »The experience of Hungary, Lithuania and Poland suggests that reformed communist parties can extend economic reforms once they have been introduced.«[53]

If reforms are hampered (and the experience of Romania and Bulgaria indicates that a policy of stalled reforms can be sustained for years), the international community should respond adequately by withholding assistance until solid evidence of reforms is available.

There is evidence suggesting that the international institutions have realized the necessity for lending policy changes based on their decade-long experience with the post-communist countries in transition:

> To reduce the risk of IMF resources being misused by countries, the IMF Executive Board in March 2000 strengthening the IMF's existing safeguards on funding, specifying new requirements that each borrower's central bank publish annual financial statements audited to international standards by outside experts. The IMF will be able to carry on-site checks by IMF staff, experts from other central banks, and accountancy firms. New borrowers are required to supply detailed international about internal controls, and audited central bank statements for the previous three years.[54]

The EU, on the other hand, plans to gradually transfer control of its assistance to local agencies, with the perspective to create permanent bodies which will be responsible for administering EU funds after accession. This initiative is of course logical, but in view of the countries nascent institutional framework it would be better that a transfer of substantial responsibilities take place at a later stage. At this point, the more external control and expertise available the better. In this respect the EU initiative of twinning is extremely helpful toward enhancing the institutional capacity of the candidate countries.

53 EBRD Transition Report. London 1999, p. 105.

54 Wolf, Tomas/ Gürgen, Emine: Improving Governance and Fighting Corruption in the Baltic and CIS countries. In: IMF Economic Issues 21 (2000). In: http://www.imf.org/external/pubs/ft/issues21/index.htm.

To sum up, the last decade of transition in Bulgaria and Romania offers a number of important lessons for the international institutions. The most important conclusion that could be derived from this experience is that the international institutions should be more sensitive as to the political situation in the two countries when planning economic assistance programs in order to ensure optimal support for democratization and reforms. This conclusion stems from the socio-political idiosyncrasies of the countries, understanding of which is crucial for enhancing reform. In both societies there are considerable sections of the population (rural population, low-level urban workers, retirees) which continue to vote anti-reform governments in power misguided by the latter's populist policies. Experience in Bulgaria and Romania had clearly demonstrated that the only way to inform the bulk of the population that populist policies are detrimental for the country's future is through a full-blown crisis. Having this in mind, the international institutions should not help delaying this crisis through aid to anti-reform governments, as the human cost of this delay is greater than that of the crisis itself. Thus the international community should help keeping the »window of opportunity« open as long as possible.

Of course there is always the counter-argument to intervention, stating that »international integration leads to national disintegration«.[55] This argument is not applicable in the cases of Romania and Bulgaria. The last 10 years of transition in both countries indicate that building institutional capacity and a functioning market economy can only be achieved with the help of the international community's financial assistance and expertise. Hopefully the lessons from this experience will serve the international institutions to improve the efficiency of assistance and thus enhance development.

55 Chilean Intellectual Osvaldo Sunkel, qut. in: Bhagwati, Jedgish: Globalization in Your Face. In: Foreign Affairs (July/August 2000), p. 136.

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