

BTI 2008 | Romania Country Report

Status Index	1-10	8.31	# 17 of 125	
Democracy	1-10	8.55	# 18 of 125	➔
Market Economy	1-10	8.07	# 15 of 125	↗
Management Index	1-10	6.52	# 22 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	21.6	HDI	0.81	GDP p.c.	\$	8,060
Pop. growth ¹	% p.a.	-0.2	HDI rank of 177	60	Gini Index		31.0
Life expectancy	years	72	UN Education Index	0.90	Poverty ³	%	12.9
Urban population	%	53.7	Gender equality ²	0.49	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Political and economic developments from 2005 to 2007 were marked by two events. The presidential and parliamentary elections of December 2004 resulted in another reversal of political fortunes. Incumbent President Ion Iliescu was replaced by Traian Basescu of the oppositional Justice and Truth Alliance (Democratic Party and National-Liberal Party). At the same time, Iliescu's ruling party emerged victorious from the parliamentary elections. The coalition negotiations, however, resulted in a fragile and divisive four-party coalition, which in 2006 became a three-party coalition with a very narrow majority in parliament, led by Prime Minister Calin Popescu-Tariceanu around the Justice and Truth Alliance, avoiding a difficult cohabitation phase. An important factor motivating the creation of a reform-oriented (albeit not tension-free) government was the final phase of the EU accession process for Romania and Bulgaria. Having missed the Eastern enlargement of 2004, Romania came under intense EU scrutiny and had to accomplish a surge of reforms to qualify for accession on 1 January 2007. Permanent EU monitoring, the safeguard clause in the Accession Treaty and the threat of postponement for another year loomed large over Romanian politics throughout the period under review. As a result, the quality, consistency and implementation of reforms clearly improved, but the dynamics and speed of the reform process remained problematic, albeit partly for different reasons. Due in part to EU conditionality, Romania has made considerable reform progress since 2005. This includes judiciary reform, anti-corruption policies, structural reforms in public administration, as well as reforms of the health care system and the labor market. Nevertheless, some of the Romanian economy's structural deficits are also linked to the EU accession process and Romania's participation in the EU internal market. The share of low-productivity and subsistence agriculture in the Romanian economy (higher than any other candidate of the 2004/2007 enlargement) and the high EU standards have both been detrimental to Romanian competitiveness in the global

market. Romania's labor productivity, for instance, continues to hover around one third of the EU-25 average. A period of solid economic growth since 2000 and the neoliberal strategy of the new government have enhanced some of the existing transition risks such as inflation, uncontrolled wage increases, an overheated credit system and a rising current account deficit. Conversely, the new policy (especially fiscal reform) has also boosted public budgets, producing revenues that have exceeded expectations, helping to fill in historic gaps in infrastructure and social services financing. Although the coherence and strategic quality of governance has definitely improved, taming these risks requires a continuation of cautious and farsighted policies in government and the central bank, combined with solid economic growth.

History and Characteristics of Transformation

Historically, Romania has been characterized by a modernization gap between the southern and eastern regions under Ottoman domination until 1878, and the more modern, urbanized economy of the western and northwestern regions, which were under Habsburg rule until 1918. The modernization of the unified Romanian state in the interwar period was a political and economic modernization in dependency, a process that continued the trend initiated in the mid-nineteenth century. Western models of statehood, democracy and a market economy were grafted onto a Romanian society rooted in qualitatively different traditions. The result was a quasi-democracy dominated by a small political and economic elite neither representing wider societal interests nor having internalized the concept of the sovereignty of the people. National mobilization became a substitute for modernization and an integrative strategy.

Despite a breakthrough strategy after the communist takeover in 1945 –1947, the regime has perpetuated some of the deficits of the prewar period, especially during the last decade of Ceausescu's rule. Again, an external model of modernization was grafted upon a Romanian reality. Political elites continued to perceive the state and the bureaucratic apparatus as property rather than a policy instrument, resulting in rampant nepotism, etatism and simulated reforms – even in the more liberal decade after 1965. By the early 1980s, the combination of an autonomous foreign policy and Stalinist approaches to modernization and domestic control had run its course, resulting in nationalist mobilization and economic decay.

Lacking an outspoken and influential opposition – partly because the Ceausescu clan monopolized national(ist) mobilization and repressed any organized dissent or independent voice within the party – the revolution of 1989 was essentially a power struggle among different segments of the nomenclature rather than the promising beginning of political transformation. Thus, although Romania was the only country in Eastern Europe to witness a violent end to communism, the net outcome was generally

rated as more of a “palace revolution” within the nomenclature than a clear break with the past. Being highly distrustful of market economics and pluralist democracy, and facing some distinct disadvantages in comparison to most of the other East European EU accession states, Romania increasingly fell behind in the reform process.

When the democratic opposition finally won the presidential and parliamentary elections in 1996, the expectations were correspondingly high. The new regime of President Constantinescu and the Democratic Convention of Romania (DCR) initiated the restructuring of heavy industries and the mining sector, liquidated and consolidated the banking system, privatized several large state-owned enterprises, liberalized most input prices and established the full convertibility of the Romanian currency. As the various DCR-led governments lacked political coordination and failed to settle their internal political differences, they lost the presidency and the parliamentary majority in 2000. Ion Iliescu was elected as president and a minority government of the Social Democratic Party led by Adrian Nastase entered office, supported by the opposition Democratic Union of Hungarians in Romania. As a result, those who had taken over power after Ceausescu’s ouster in the December 1989 revolution are now back in office. The amateurish politics of President Constantinescu and the center-right Democratic Convention (1996 – 2000) created a sense of reform fatigue and political disillusionment among the electorate. A broad impression of policy failure, although only partially justified, added to the extreme uncertainty and hardship among reform’s losers.

While many politicians from the first and second Iliescu presidency (1990 – 1996) returned to power “sadder and wiser” in 2000 after four years in opposition, most political parties now feature younger management for the first time since the revolution of December 1989. The stability of the political system, however, was deceptive and based on shrewd control and clientelism rather than a culture of constructive policy-making. Simulated reforms, etatism, nationalist rhetoric and blurred distinctions between the state, parties and private sector still run high in Romania. Overall, the new leftist government did better than most analysts expected, probably because popular expectations were at an all-time low and because the process of EU integration provided much-needed assistance as well as the basic framework and incentive for reforms. The macroeconomic balance management was especially, and somewhat surprisingly successful under the re-labeled Social Democrats, with good control of public expenditure that left the country with very low deficits at the end of 2004. They also managed to conclude all the acquis chapters negotiated with the European Union, albeit with notable red flags concerning the judiciary, the battle against corruption and institutional preparedness for EU funds.

The first decade of the Romanian economic transformation process suffered from some disadvantageous framework conditions including erratic management, and wavering popular support for economic and political transformation. The size of the national economy and the predominance of a poorly mechanized agricultural sector on the one

hand, and run-down obsolete industrial complexes on the other hand, have made transformation particularly challenging. Ceausescu wielded much damage by striving for autarky in paying off foreign debt at the expense of domestic consumption and investment in capital goods.

In light of the reluctance of successive governments to implement reforms that would make them unpopular because of transition hardships, price liberalization and labor reduction has produced legacies of bad credits, backlogs in large privatization and pseudo-employed workforces. The changes of government and the absence of a coherent concept with enough public and political backing have resulted in erratic transformation policies, especially regarding privatization and its ever-changing laws and institutional frameworks. This has made both the Romanian population and international investors extremely wary. Overall, the hesitation in thorough transformation has been self-defeating. By losing the initial momentum domestically, and by lacking competitiveness for Western investment within the former Eastern bloc, critical resources for constructive policies have been depleted.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force has been uncontested throughout the territory. Autonomist and secessionist rhetoric among some representatives of the Hungarian minority has entered the political debate, but poses no threat to state sovereignty.

Monopoly on the use of force

By historical tradition, the Romanian concept of the nation is defined strongly in ethnic terms. The Romanian constitution defines the nation in ethnic terms ("national sovereignty resides with the Romanian people") and provides the normal guarantees of liberal constitutionalism. A civic concept including the strong Hungarian and Roma minorities has thus far failed to find acceptance beyond formal legal texts. The initiation of a Roma Inclusion Plan is a positive step in countering widespread stereotypes and discriminatory practices. Support for nationalist-extremist, openly anti-Semitic and xenophobic parties and movements (the extremist, xenophobic and anti-Semitic Greater Romania Party received 13% of the vote in the 2004 elections) indicates that public perceptions of citizenship may be disharmonious with constitutional stipulations. However, the state's constitution and official citizenship are not directly challenged. Rather, political rhetoric and everyday practice deviate substantially from legal concepts of the nation and civil rights. On the other hand, the Democratic Union of Hungarians in Romania (UMDR) has been part of all government coalitions since 1996.

State identity

Since the end of communism, the Orthodox church has remained independent from politics and religious dogma has not had an impact on state policy-making. Nevertheless, the Romanian Orthodox church's insistence on being recognized as the privileged denomination blocked a new law on religions for more than five years. The new 2006 Religion Law is generally seen as slanted in favor of the Orthodox church, with registration and recognition requirements creating obstacles for minority religions.

No interference of religious dogmas

Partly because of the existing communist administrative structures, Romania has reformed state institutions since 1989 with increasing EU assistance and guidance. The administrative structures and resource allocation encompass the entire country.

Basic
administration

2 | Political Participation

The most recent parliamentary and presidential elections of November 2004 were generally considered “free and fair,” despite the mutual incriminations and allegations of fraud and manipulation by the two political camps. The Romanian Media Monitoring Agency particularly criticized biased radio and TV coverage of the 2004 elections. The fact that each circle of elections in post-communist Romania has resulted in a reversal of the ruling coalition and opposition without risk for the system of democratic representation has been indicative of both the maturity of the Romanian political landscape and the consolidation of democratic procedures. There are no relevant restrictions on suffrage and no groups are barred from executing their passive or active electoral rights.

Free and fair
elections

Democratically elected rulers do have the effective power to govern. As such, no political enclaves exist, although some interest groups and stakeholders have demonstrated disproportionate political influence and may be considered to have limited veto powers. Both managers from state and private corporations as well as trade unions have the power to block reform processes. Thus, Romania ranks high in indices reporting on state capture.

Effective power
to govern

The Romanian 1991 constitution provides the usual political and civil liberties, including freedom of expression, association and assembly. In 2004, the Civic Hungarian Union – a dissident faction of the Democratic Alliance of Hungarians in Romania – was prevented from registering as a candidate party by direct and indirect means. Since the change of government, the inclination to curtail these freedoms beyond the formal rules has declined markedly.

Association /
assembly rights

Similarly, freedoms of opinion and the press are generally protected adequately. Although most media outlets continue to hold a clear political preference, the culture of political reporting is changing and overt political interference is declining. In a preliminary, but telling step, the National Audiovisual Council, the independent media watchdog institution, has asked all TV networks to reveal their ownership structures. Similar transparency measures were introduced for media advertisements. The weighing in of owners over the professional independence of journalists, however, continues to be common practice. A few active NGOs that act as watchdogs for media independence, such as the Media Monitoring Agency, the Center for Independent Journalism and the Romanian Press Club indicate their awareness of civil society regarding the issue of press freedom.

Freedom of
expression

3 | Rule of Law

State powers in Romania are independent and checks and balances in political power are stipulated in the constitution. The current government has somewhat reduced its predecessor's tendency to consider "obsolete" the protracted and partly redundant legislative procedures of the two chambers of parliament by choosing to rule by emergency ordinances that only required retrospective legislative approval. For instance, in an average cabinet meeting on 13 December 2006, the government had one law, two executive ordinances and six executive decisions on the agenda. Between February and July 2006, the government signed no less than 105 emergency ordinances. To some extent, ruling by ordinance is excused by the urgency of the EU accession process and the corresponding "executive bias." Judges also complain about the strong influence exerted by high level politicians who comment on ongoing proceedings or make general and superficial assumptions about how the system functions.

Separation of powers

The functioning of the judiciary is partly restricted by deficits in transparency and efficiency as well as corruption. The March 2005 Strategy and Action Plan for the reform of the judiciary and the strengthening of the position of the Superior Council of the Magistracy have marked significant steps forward. The controversial constitutional amendments of mid-2005 have provided guarantees for magistrates' personal and institutional independence with the General Prosecutors and the General Prosecutor of the National Anti-Corruption Prosecution Office as anti-corruption watchdogs. The prioritization of professional qualification in the appointment of magistrates rounds off the reform package. The revocation of the General Prosecutor's competence for extraordinary appeals and the introduction of transparent criteria for the random allocation of cases to judges to avoid conflicts of interest have been rated positively and contributed substantially to the judiciary's professionalism and independence. As all these improvements have been achieved under the pressure of the safeguard clauses on justice, there is a general internal and external fear that the rhythm and quality of these reform steps will slow down with EU membership achieved.

Independent judiciary

Political corruption, while endemic under the previous Nastase government, continues to be a serious issue, as the European Union's monitoring and reform priorities indicated. Starting with the 2003 constitutional amendment limiting parliamentary immunity, the dire reputation of the outgoing PSD government and the fiery civil-society campaign against political corruption have produced results in the fight against the abuse of office and a change in political culture toward accountability. Anti-corruption mechanisms have improved and awareness has increased. This reduction in corruption can be attributed to the fact that within the

Prosecution of office abuse

coalition government there are now more nuclei of power in competition. This has also made it more transparent, since they tend to report on each other. According to media reports, however, the finance minister was replaced in the autumn of 2005 when he set out to tackle corruption in the customs service.

In line with the EU accession process, all formal legal guarantees for a fair process on equal treatment and non-discrimination legislation are in place. There is also a universal policy of minimum guaranteed income administered by local governments, and a quite generous maternal subsidy policy, which includes two-years of maternal leave with the salary paid by the state that is gender-neutral under the law. The Roma will be a major concern for the European Monitoring Centre on Racism and Xenophobia (EUMC). Its monitoring after accession will be important as the final EU monitoring report prior to accession reported only “limited progress” with respect to the fight against racism and related discrimination. There are reports of police raids against Roma communities. Conversely, through the creation of regional National Agency for Roma offices, various literacy, employment and housing programs have reached the local level. International reports, however, consider the Agency underfunded and understaffed. At the same time, the relevant ministries now consider the Agency solely responsible for all policyfields that specifically concern Roma specifically.

Civil rights

4 | Stability of Democratic Institutions

The very size of the state administration, the networks of clientelism, and the fragmentation and volatility of public institutions in Romania continue to result in counterproductive frictions. These factors and a lack of functional cooperation between central ministries and agencies continue to be directly related to the dominance of the executive. Deficits in administrative institutional capacity have been a spearhead of EU criticism in the 2005 Progress Report and the final September 2006 Monitoring Report. Within the process of administrative reform and decentralization, parliament adopted in July 2005 or 2006 a law on local public finance and a law on civil servants, while a new law on unitary pay for civil servants was delayed. The transfer of state competencies to the regional and municipal levels, however, is slow and marred by the deficits in local administrative capacities and the definition of subsidiary responsibilities. Finances and recruitment are two of the main stumbling blocks. At the central level, however, the government has improved the mechanisms for strategic policy formulation/coordination and impact assessment at the level of ministries and General Secretariat of the government.

Performance of democratic institutions

Arguably, extremist nationalistic organizations such as the Greater Romania Party or the Romanian National Unity Party (now absorbed in the Conservative Party) question the precedence of democratic institutions over “the nation.” By and

Commitment to democratic institutions

large, however, they have nevertheless accepted these institutions and followed democratic procedures in practice. Romanian Hungarian hard-liners outside the ruling UDMR tend to demand extensive autonomy and even consider the idea of secession as a bargaining chip, again without actually actively endangering the constitutional order. Overall, the nationalist-extremist wing of the political spectrum is not fundamentally committed to democratic institutions. External and domestic constraints exclude a fundamental reversal of democratic order, but political attitudes and public opinion point to a certain preference for an authoritarian governing style. Recent surveys, however, indicate that these preferences are waning and democratic awareness is increasing.

5 | Political and Social Integration

As the last elections in 2004 indicate, there is still substantial fluctuation of parties, leaders and electoral choices between elections. The number of parties participating in parliamentary elections remains high (over 30 parties in the 2004 elections, although only six parties with two alliances passed the threshold). The profile of the main contestants (PNL, PSD, PD, UDMR and PRM) seems to be consolidating with a more pronounced political program and basis in society. The PSD dominates the left wing, whereas the center right consolidated around the victorious electoral coalition PNL-PD of 2004. Right-wing votes are increasingly concentrated on the PRM and within a new party with a similar profile set up by a millionaire football club owner, the Party of the New Generation (PNG). Polarization within the political spectrum is high as (unlike in Central Europe) the dichotomy between “former communists” and “democratic opposition” largely perpetuates itself, despite the rise of a nationalistic right. Whereas the PSD is particularly strong in the rural and poor regions of the northeast and south, the constituency of the democratic opposition is concentrated in the cities and more affluent provinces. Despite regular splits and mergers (e.g., the morphing of the Humanist party into Conservative Party after the elections, the Ciontu Group splitting within the PRM and the Liberal Democratic Party (PLD) forming in December 2006 as a breakaway group from the PNL) the main parties are stable, voter volatility notwithstanding. A typical problem of instability concerns the mobility of elected officials between elections for opportunistic reasons, which creates new parties based on personal ambitions rather than programmatic profiles. Based on parties (not alliances), the 2004 Laakso/Taagepera Index for the Romanian Chamber of Deputies is 5.08 – a relatively modest effective number of parties in regional comparison.

Party system

Romania features some high-profile social and policy-advocacy NGOs with a substantial impact on policy-making. Civil society organizations are fragmented, weakly rooted in society and often perceived as elitist. A number of well-placed

Interest groups

(i.e., in relation to the international community) NGOs have been able to exert substantial and beneficial influence on government policy-making in recent years. A few of them have established themselves as functional think tanks or human rights organizations. The current government has in principle been more aware of the risks involved in complacency to the desires of particular interest groups, such as well-connected business groups. Meanwhile, several nationalistic, xenophobic and extremist organizations have found mass appeal, undermining civil integrity and democracy. Conversely, the Hungarian minority has demonstrated a high degree of ethnic organization and their civil organizations have largely been constructive actors.

Eurobarometer 2006 indicates that Romanians trust first and foremost the church, the mass media, the army and international organizations, which is not atypical for the 2004/2007 new EU member states. The GfK Trust Index measuring trust for various professional groups (spring 2006) confirmed these findings. While politicians in Romania scored lower than any other group (16, against 64 for journalist and 89 for teachers), this is in line with the European average for politicians (14). In the second Eurobarometer for 2006, the media, the UN, the church and the army rate between 60% and 80%, whereas democratic political institutions are concentrated on the lower end of the scale (political parties – 12%, parliament 24%, trade unions 25%, the judiciary 26% and the government 27%). Paradoxically, in the same poll, 47% of the Romanian respondents are convinced that “generally speaking, things are moving in the right direction,” and only 23% are of the opposite opinion. This ratio is very similar to other new member states. In a ranking of important personal values, however, at 21%, democracy ranks far below peace, human rights and security.

Consent to
democratic
norms

Civil society organizations tend to be interest-advocacy oriented for specific social groups whereas larger internationally connected NGOs tend to be quite isolated from constituencies in Romanian society. Due to the long socialist tradition, inclinations are either to resort to state assistance and guidance instead of societal self-organization or – in the case of the winners of transition - to opt for a highly individualistic approach.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Due to the growing urban-rural disparities in the processes of socioeconomic transformation and European integration, social exclusion is structurally ingrained in Romania. Gender is hardly a factor, as the GDI is close to 100% of the HDI, but other UNDP poverty-related indices indicate that poverty, though not extreme, is a serious and substantial problem: 21.5% of the population lives below the national poverty line (1990 – 2003). The Gini index of 31.0 points in the same direction. The poorest 10% of the population has a 3.3% share in income/consumption, while the richest 10% share 24.4%. In terms of social inequality, sectoral disparities are key. For 2005, industry contributed an estimated 24.4% of GDP, agriculture a mere 8.9%. At the same time, industry's share of the labor force is a similar proportion, but agriculture and forestry accounts for roughly one-third of the labor force.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	45,825	59,507	75,489	98,565
Growth of GDP	%	5.1	5.2	8.4	4.1
Inflation (CPI)	%	22.5	15.3	11.9	9
Unemployment	%	8.4	7.0	8.0	-
Foreign direct investment	% of GDP	2.5	3.1	8.5	6.7
Export growth	%	16.9	7.1	15.9	4.2
Import growth	%	12.1	13.6	18.3	3.7
Current account balance	\$ mn.	-1525.0	-3311.0	-6382.0	-8503.5
Public debt	\$ mn.	9,034.4	11,729.4	13,666.9	13,341.1
External debt	\$ mn.	16,693.9	22,629.5	30,120.9	38,694.2
External debt service	% of GNI	7	6.1	6.4	7.1

		2002	2003	2004	2005
Cash surplus or deficit	% of GDP	-2.0	-	-	-
Tax Revenue	% of GDP	11.7	-	-	-
Government consumption	% of GDP	6.8	10.1	9.8	9.9
Public expnd. on edu.	% of GDP	3.5	3.6	-	-
Public expnd. on health	% of GDP	3.7	3.8	3.4	-
R&D expenditure	% of GDP	0.4	0.4	0.4	-
Military expenditure	% of GDP	2.3	2.2	2.1	2.0

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

The new government's urgent decision to immediately introduce a 16% flat tax on 1 January 2005 illustrates the strategy to reduce the state's obstructive role and redefine it as a facilitator, rather than a controller of market processes. A substantial informal economy and the state's role in the economy hamper a viable market economy in Romania. By 2006 estimates, the informal sector has increased significantly. According to official estimates, 1.2 million workers are employed in the informal non-agricultural sector, while the total figure including the agricultural sector is apparently much higher. However, the institutions of a market economy are in place and include the freedom of trade, currency convertibility, etc.

Market-based competition

While formal regulations prohibiting monopolies exist, the Competition Council and other market arbiters, though fully in line with the *acquis*, are still in reality weaker and more timid than they should be. The granting of monopoly power to state-owned companies is the key problem in the Romanian case. Moreover, some early entrants on the market at the beginning of the 1990s have secured preferential treatment and tend to oppose the complete liberalization and transparency of markets and state allocations. In 2006 however, the European Commission estimated that one of the key doubts concerning Romania's preparedness to meet the requirements of membership is related to its competition policy. One of the identified weaknesses concerns the strict implementation of bankruptcy procedures against tax debtors. More bankruptcy cases were concluded in 2005 and the administrative capacity of the Competition Council was enhanced.

Anti-monopoly policy

With EU accession, Romania has joined the internal market of the European Union and the EU member states have since long become its major trading partners. With respect to EU monitoring, the free movement of goods have caused only minor concerns in the case of Romania in recent years, relating mostly to the transposition of cultural goods.

Liberalization of foreign trade

Non-performing loans have been radically reduced over the past few years and the financial sector has consolidated while stock market capitalization and domestic credit are beginning to grow. The EBRD has critically assessed Romania's progress in reforming its banking sector and non-bank financial institutions. Domestic credit to the private sector is on the rise and the national bank has accordingly tightened controls as consumptive credits endanger the trade balance. Romania fulfilled the harmonized rules for the financial sector prescribed by the EU acquis. In 2005, 24 out of 33 banks were foreign owned and held nearly 60% of all assets, compared to state banks, which hold a mere 6.5%. Stock market capitalization and trading volume are increasing rapidly. Credits to the private sector are slowly but steadily on the rise, while non-performing loans are decreasing.

Banking system

8 | Currency and Price Stability

The exchange rate of the Romanian lei (RON) to the U.S. dollar has been managed adequately by the independent National Bank. However, after three years at 3.3 RON/dollar, in 2005 the lei appreciated to 2.9 RON/dollar, and in subsequent years to 2.6-2.7 RON/dollar. International financial institutions have applauded Romania's improved budgetary discipline, but due to extraneous factors, the need for targeted government investments and largely uncontrollable wage increases, the government had to increase the 2005 inflation target to 7.5% instead of 6.0%.

Anti-inflation / forex policy

The government's budget balance (-1.4% of GDP in 2004, -0.8 in 2005) underscored the new government's sincere and partly successful efforts to curb the deficit and increase Romania's credibility with international financial institutions. The -2.5% estimate for 2006, however, is largely due to external factors and policy priorities rather than politically motivated overspending on the government's part. In real terms, the consolidated budget has fluctuated between 29.5% and 31.5% of GDP and there was an increase of 1-1.5% in both collections and expenditures after the 2005 tax reform (tax cuts, flat tax, etc).

Macrostability

9 | Private Property

Although Romanian legislation on the acquisition and protection of property rights is generally in line with the EU acquis, the protection of intellectual and industrial property rights continues to demonstrate deficits despite stepped-up efforts to prosecute copyright-related crimes.

Property rights

Although the privatization process had been erratic, it finally reached its completion with the privatization of a number of major state-owned enterprises in the energy sector in 2004. The private sector share of GDP reached 70% in 2006.

Private enterprise

10 | Welfare Regime

Organized by the state, social security covers all relevant risks in principle. As the high poverty rate indicates, social security functions on a subsistence level throughout the country. Similarly, health care is available for all citizens throughout the state territory, but is insufficient, especially in rural settlements. More importantly, social disparities and inequality in access to health care and basic services are increasing rather than decreasing.

Social safety nets

Romanian society retains elements of heterogeneity and discriminatory access. Education, basic social security and health care offer limited compensation for social inequality. Egalitarian attitudes are widespread in the state-provided services, but a lack of resources is paramount. In the long run, the main threat to state welfare services is represented by a gradual depletion of assets due to poor policies, the government's lack of analytic and feedback capacity, indecision in applying necessary but painful remedies and periodic outbursts of populist commitments. The UNDP Gender Empowerment Measure (0.492 for 2004 against 0.465 for 2003) and other relevant indicators indicate some progress. Disparities are first and foremost socioeconomic, and while the existing policies and institutions are consolidated enough to prevent socioeconomic deterioration, they are not powerful enough to compensate for gross social differences and to achieve equality of opportunities.

Equal opportunity

11 | Economic Performance

GDP growth is high, but burdened with a number of domestic and external risks and structural deficits. With EU membership and the economic growth of recent years, Romania is rapidly eroding its global competitive advantages. Wages and consumption are rising above labor productivity increases, which adds to the inflationary risks admonished by the international financial institutions. The

Output strength

appreciation of the lei and consumerism combined with a loss of competitiveness have resulted in a growing external debt of 33% of GDP (albeit one of the lowest levels in Europe) and an unsustainable trade deficit of some 27% in 2005.

12 | Sustainability

To some extent, environmental hazards have been reduced by de-industrialization, but air pollution due to industry is still significant in some cities and in the northwest. The Danube delta wetlands are threatened by water contamination. Although Romania has managed to close negotiations on the relevant *acquis communautaire* chapter, the implementation of EU environmental protection standards remains minimal in practice. Some of the environmentally risky industrial projects are debated controversially today, such as the Rosia-Montana gold mining project.

Environmental
policy

As part of the wiser and more farsighted investment of government expenditures, the new coalition has substantially increased funding for research and development, although most of it was wasted on internationally non-competitive state universities and institutes of the Romanian Academy. The estimated 0.4% of GDP in 2006 and the projected 0.7% for 2007 mark a substantial increase over the 0.27% achieved in 2005. Although these percentages are below the OECD average, the human capital situation in Romania is quite promising by regional comparison.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

Several factors in various fields combined to constrain policy options for transition management in Romania. The PSD regime (2000 – 2004), with its strong rural base and connections with the rural nomenclature, has failed to create a more thorough policy of rural transformation. The prominence of subsistence farming in Romania continues to act as a key socioeconomic constraint, as does the sheer size of the country with its relatively low degree of urbanization, major regional disparities, and strong links between smaller cities and rural areas. Forced industrialization in the 1950s and 1960s and the austerity policies of the 1980s have produced non-viable and run-down heavy industry. Weak infrastructure adds to the structural obstacles to socioeconomic transition in rural areas. The absence of a clear political break from and disavowal of the communist nomenclature in the management of agricultural and industrial enterprises have left an unfortunate legacy. The apparent lack of a viable alternative was perpetuated by the utter failure of the democratic opposition's interregnum from 1996 to 2000 and the feet dragging in socioeconomic reforms under the next government. Thus, the generational and urban-rural gaps have widened. A younger urban population reaps the profits of an uneven, but accelerating transformation process, whereas the rural population remains ill-equipped for the consequences of market economics and social change. The continuity of a strong xenophobic nationalist tradition from communism to post-communism has increased conservatism and popular resistance to reforms. Unlike in Bulgaria for instance, the strength of the nationalist-extremist political wing has distorted the "normal" dynamics of a neo-communist versus democratic-reformist bipolarity. On the one hand, the prospect of EU membership and the process (including guidance and assistance) of accession since 1999 has stimulated the reform process. Yet, the deeply ingrained tradition of simulated reforms and state capture, combined with the structural skepticism and subversion of the population vis-à-vis state policies have at times brought the reform process to a virtual standstill.

Structural
constraints

Civil society traditions are weak, with a small number of active and sustainable NGOs and limited participation in public life and voluntary associations. Despite

Civil society
traditions

reforms driven by EU accession, institutional stability and the rule of law still suffer from significant deficits. In contrast to Bulgaria or Serbia, the anti-intellectualism of Romanian communism regarding active, competent NGOs and think tanks was pronounced. The governmental demand for European expertise within NGOs has gradually modified relations between state institutions and civil society. Prominent examples include civil society activist Monica Macovei joining the current government as Minister of Justice and the effective anti-corruption and accountability campaign by civil society organizations during the 2004 elections.

Ethnic Hungarians constitute the main ethnic minority and despite their involvement in each government since 1996, the potential for ethnic conflict remains. However, it is currently subdued despite the electoral strength of extremist-nationalist parties. Nationalist parties' virulent racist and aggressive propaganda, however, finds resonance among significant sections of the population. Nevertheless, ethnic divisions do not predetermine politics. Whereas religious antagonism is insignificant, the potential for social conflict is much higher because of the high poverty rate. Further income disparities are bound to aggravate these social tensions. The Roma population's social rather than ethnic problems, including widespread discrimination, exacerbate these tensions. The statute of national minorities providing for forms of cultural autonomy of national minorities and the confirmation of the principles of equality and non-discrimination was a formal step forward, but the authority and functioning of the National Agency for Roma remained unsatisfactory. Actual sanctions against anti-Roma discrimination have increased, but equal treatment remains a farfetched objective in daily life.

Conflict intensity

II. Management Performance

14 | Steering Capability

The period from January 2005 to January 2007 encompasses the Basescu presidency (Basescu was sworn in on 20 December 2004), and the Popescu-Tariceanu government, which was installed on 29 December 2004. The quality of the reform process has improved markedly in recent years, partly due to the reform agenda of the new government and partly due to the increasingly urgent and strict EU conditionalities. Although the harmonization of the various political issues and agendas remains a key deficit, (financial) realism in policy

Prioritization

projection has increased substantially. The current government's neoliberal strategy has contributed to the dynamism and a more coherent orientation of reform policies, albeit to the detriment of (slow) democratic procedures (the executive bias of EU accession).

The government is committed to democracy and a market economy, but has only limited success in implementing reforms and overcoming structural obstacles. Demographic and macroeconomic pressures resulted in growing pension deficits, and a modern three-tier pension system was designed in 2000. Parliament, however, allowed for delays in fully implementing the strategic pension reform. In many cases, follow-through on reforms was the main problem, as the cases of anti-corruption policies or the introduction of a flat rate tax demonstrate. When the correct initial policy choices were made and accepted by the European Union and international financial institutions, the government failed to pay the same attention to their actual implementation and allowed interest groups (even in the case of anti-corruption) to sabotage strategic orientation in party politicking or simulated implementation.

Implementation

The current government has demonstrated an enhanced awareness of structural dilemmas and responded more consistently and flexibly to policy failures and unintended consequences of previous policies. The government risked higher inflation for the sake of other policy priorities and introduced the 16% flat rate tax against substantial opposition.

Policy learning

15 | Resource Efficiency

Progress in reforming the traditional centralism of the Romanian state remains cumbersome and half-hearted. As of 2006, prefects can no longer be affiliated with a political party. In most cases, however, prefects in office renouncing their party affiliation sufficed instead of installing truly independent prefects. Administrative capacity deficits and a lack of financial resources hamper effective decentralization as much as the open question in a subsidiary catalogue of competencies. New mechanisms for strategic planning and impact monitoring have not been in operation long enough to assess. Conversely, total tax arrears remain large at around 8% of GDP.

Efficient use of assets

Targeted government investment in strategic priorities has improved (e.g., the flat tax system, education or stimulating foreign direct investment). Nevertheless, discord and politicking within the three/four-party coalition rather than inter-agency frictions have stalled some reform projects. Most importantly, the personal tug-of-war between President Basescu and Prime Minister Tariceanu resulted in the ouster of the foreign minister in early 2007. The overall neoliberal outlook of the current government has made social policies and rural

Policy coordination

development a substantial unaccounted lacuna in the strategy of EU integration and socioeconomic transformation.

The new government made anti-corruption a high political priority, although predictably some PSD leaders claimed this to be a politically motivated action. The government's ability to tackle high-level corruption has improved by the reorganization and empowerment of the relevant agencies and by reducing immunities for elites such as former ministers. The quantity and quality of nonpartisan investigations by the new National Anti-Corruption Directorate (DNA), which was introduced by Minister Macovei, into allegations of high-level corruption has improved substantially. This has resulted in several court convictions involving a former deputy prime minister, two state secretaries, seven members of parliament and 54 police officers. Yet, the National Agency of Integrity – an autonomous, permanent administrative structure charged with the control of assets declaration, conflicts of interest and incompatibility for public officeholders – was not adopted by parliament until 2007, two years later than planned. The fact that the government backtracked on its reform of the notoriously corrupt customs service indicates that private interest groups remain powerful within the political establishment. Moreover, new anti-corruption instruments, such as the detailed declaration of assets and income, mandatory for dignitaries and civil servants, are constantly under threat of being scaled back, especially by parliament.

Anti-corruption
policy

16 | Consensus-Building

Although the political establishment has accepted in principle the goals of a market economy and democracy, a sub-current of etatism remains.

Consensus on goals

As the meta-objective of EU accession by 2007 had before long become an uncontested benchmark for all reform projects and policy priorities among the mainstream political parties, no anti-democratic or anti-market actor could execute veto power. Thus, agents of reform in Romania managed to co-opt potential veto actors within the agenda of EU membership.

Anti-democratic veto
actors

The party landscape is to a limited extent representative of societal groups and cleavages. The Tariceanu government has not been able to reverse the trend of growing social and urban-rural disparities. The main Hungarian party's participation in government has helped diminish the ethnic divide. Recent programs are intended to improve the integration and acceptance of the Roma population.

Cleavage / conflict
management

By upholding the key role of the state in most policy fields, albeit at a basic level, the government promotes continued reliance on the state rather than

Civil society
participation

societal engagement. The state engages with think tanks and NGOs only when necessary as a result of Western pressure or the organization's increasing popularity or when the state administration itself lacks the requisite competence. The gradual increase in career permeability between government bureaucracy and political representation on the one hand, and civil society and advocacy organization on the other hand, has resulted in a number of (younger) key politicians such as Foreign Minister Mihai Ungureanu and Minister of Justice Monica Luisa Macovei with professional experience outside the Bucharest political establishment .

Due to the quasi-revolution of 1989 and the ensuing continuity of the political and economic elite, violations of human rights under the Gheorgiu-Dej and Ceausescu regimes were not tackled comprehensively and purposively during the first decade of post-communism. Concerns about Romania's international reputation, particularly in response to European pressure, have induced the Iliescu/Nastase regime to address specific issues more seriously. These issues include a collective and historical re-thinking of the country's communist history. Initiatives by NGOs and internationally supported academic organizations have played a crucial role in this process. Concerning the long-taboo issue of the Holocaust in Romania, the previous government installed a commission, received a highly critical report and began teacher trainings on the topic. A Holocaust commemoration day was introduced into the national calendar. The current government has continued these policies, albeit without initiating a campaign of reconciliation or anything resembling a truth and justice commission. At the end of 2006, the Romanian president read before the parliament a condemnation of the communist regime as criminal and genocidal, which was based on a report produced by a commission of independent historians. This condemnation became an official act of the Romanian state, which is likely to be used in court cases from now on by the victims of communism claiming redress. In 2005, under the President Basescu, Bucharest commemorated the 1941 pogrom by the Iron Guard, and the long-taboo subject of the Holocaust in Romania was finally integrated into the school curriculum. A genuine reconciliation campaign or a truth commission is not on the political agenda.

Reconciliation

17 | International Cooperation

With increasingly precise EU criticisms and the deadline for 2007 accession rapidly approaching, the government's urgency for reform and responsiveness to EU guidelines (if not to popular demands) increased markedly. Conversely, the strongest opposition to the 16% flat tax (an urgent key project of the new government) came not so much from the opposition, which was in a bit of

Effective use of support

disarray at that time, but from the IMF, which favored a VAT increase and even warned Brussels of Romania's fiscal policies. The government resisted, cut direct taxes, and left the VAT untouched, which spurred almost immediate budget growth, in absolute terms and as a percentage of GDP. The previous Social Democratic government had been much more in sync with international financial institutions, maintaining tight control, careful management, low deficits and better personal relations. Finally, there was no unpopular effect (no indirect tax increase, no inflation surge) and, the reform became quite popular in Romania. Meanwhile, Romania became very unpopular with the IMF, which never admitted to having erred.

Despite the drawbacks of corruption and state capture, Romania's international standing has improved, as the successful completion of EU accession indicates. Romania has given up some old habits of simulated reform – not only in terms of EU criteria – and invested more in the actual implementation of EU and/or reform-oriented legislation.

Credibility

In many fields of regional cooperation, the completion of EU accession has posed a challenge for Romania. For example, CEFTA economic cooperation as well as Southeast European regional cooperation was formally (internal market or practically) incompatible with EU membership. Conversely, Romania has taken a new and more active stance in international and regional cooperation in the security and foreign policy arenas. Examples include Black Sea cooperation and initiatives related to the stalemate conflict in neighboring Moldova. To some degree, the new Romanian government seems to aspire to take a lead role in the region and to accept its responsibilities as a new EU member state and the largest state in southeastern Europe. Although its initiatives are sometimes badly coordinated or communicated and transatlantic cooperation in the war on terror did not sit well with its European partners, Romania's international and regional engagement, and the country's responsiveness have developed beyond erratic initiatives for domestic consumption.

Regional cooperation

Strategic Outlook

In the case of Romania, the formal moment of EU accession on 1 January 2007, is widely considered to mark the end of the post-communist transition process, both politically and economically. While EU membership indeed indicates and guarantees that the democratic political institutions are consolidated and that the institutional framework for a competitive market economy is in place, Romania's laggard status within the 2004/2007 process of eastern enlargement indicates that major challenges remain.

Due to the prevalence of subsistence agriculture and unreformed rural socioeconomic structures, the rapidly growing gap between urban populations (mainly in Bucharest and cities in western Romania) and the rural majority are set to become the determining factor of Romania's future development, not only in real socioeconomic, but also in political terms. The dichotomy of reform-communists vs. democratic opposition continues to be a key issue in Romanian politics despite the fact that no incumbent government (and president) has ever managed to secure re-election. The left vs. center-right polarization of the political spectrum is exacerbated by the substantial political weight of right-wing extremist parties and mediated only by the Hungarian party. The dichotomy corresponds to the growing disparities between the rural constituencies of the reform-communists losing out in the transformation process and the urban groupings profiting from European integration and economic transformation. Restoring social cohesion and solidarity by shaping a sustainable future for rural Romania without derailing economic development and without uncontrolled urban migration and decay of socioeconomic structures in the villages is the main upcoming challenge for the national government. The track record of the EU's regional and structural funds in support of this process is mixed. More often than not, the European Union has stimulated a catch-up process at the national level, but rarely managed to counter the growing inter-regional or urban-rural disparities.

Although the European Union will continue to monitor deficiencies in Romania's reform accomplishments according to European standards, the absence of the push and orientation provided by the accession process may be dearly missed in the next phase. It remains to be seen whether the Romanian government will be able to maintain strategic coherence into the future or whether old habits of simulated reforms and politicking reappear. Concerns are high especially regarding the fight against corruption. As in other Central and Eastern European countries after accession, mainstream politicians are tempted to scale back to some extent policies and instruments that may have been put in

place merely to please Brussels and have “red flags” removed from their country reports. Conversely, with the priority of EU accession gone, politicians and civil society leaders will have to modify political culture to enhance the authority of the democratic representative institutions at the expense of today’s executive bias.