

Part II

Progress of Transition to the Market Economy in Romania

Chapter 4

The Reform programs in Romania: Comparison with the 500 Days Plan

1 Transition from the Ceausescu era

The National Salvation Front, which came into the power just after the fall of the Ceausescu regime in December 1989, launched the task of transition from the Communist Party dictatorship to the democracy in the political sphere, and from the strict socialist planned economic system to the market economic system in the economic sphere.

The new administration took several measures for transition to the market economy in a trial and error way. The first measures were cancellation of the Sistematzare of villages, and authorization of the small-scale private farming on family plots in the state and cooperative farms in January 1990. The Sistematzare of villages was the so-called urbanization movement. The first wave of the movement began in 1972, but was suspended because of the resistance of farmers and lack of the fund. The second wave of the movement, which was resumed in 1988, was internationally criticized, because it was mainly intended for the Hungarian residents in the Romanian territory¹. And, because of authorization of private farming on family plots, farmland of state and cooperative farms practically changed into the private owned little by little.

The next measure was authorization of establishment of private enterprises in February. It admitted private employment of less than 20 workers, and also free pricing to private enterprises. About 50,000 private enterprises were registered by the summer of 1990. In March, the 1971 joint venture law was revised by the decree of foreign investment, and establishment of enterprises with 100% foreign capital was also admitted.

However, these were emergent measures on a patchwork basis, not based on any necessary policy packages². Facing with the general election in May 1990, Iliescu, the candidate of the president of the National Salvation Front, had to draw up an economic reform strategy. In fact, two economic reform programs were made. The first program was "the Outline Strategy of Market Economy Implementation in Romania" (hereafter, the Outline) prepared by Tudorel Postolache, the director of the Institute of National Economy, in May, 1990³. The second one was "Program of Coordination of Projects of Economic and Social Reform" (hereafter, the Coordination Program), which was recognized as the official government program in August 1990⁴.

¹ Shen(1997), p.15.

² Regarding with the economic policies as a whole adopted in the first half of 1990, see Demekas and Khan(1991), pp.12-14.

³ Outline(1990). This book was a summary of more than 3,000 pages research paper.

⁴ Coordination Program(1990).

2 The Outline

The Outline was drawn up by the committee established by the government decision No.180/1990 on "the establishment of the government committee for drawing up the government economic program", after consultation with many foreign researchers. The conclusion of the Outline was that transition to the market economy in Romania should be accomplished not by a short-term shock therapy or a long-term gradual therapy, but by a gradual transition with a fast pace in less than two to three years. At the onset of the transition, the Romanian economy faced a serious economic crisis, because:

- (i) The centralized bureaucratic economic management under the socialist regime deprived Romanian citizens of creative initiative.
- (ii) The industrial structure was distorted (backwardness of agricultural sector, excess industrialization, energy problems, ignorance of the tertiary sector, and so on).
- (iii) The standard of living fell down significantly.

And it was anticipated that the transition might give rise to tensions, difficulties and social conflicts. Therefore, a social consensus was necessary to overcome these hardships⁵. A short-term shock therapy, which "sacrifices today for tomorrow⁶", could not be accepted, owing to the results of uneconomic and inhumanistic measures to repay the foreign debts under the Ceausescu era. A slow gradualist strategy could not be also accepted, because it could not make possible to enjoy proper living standards and European cultural standards in a short period.

The Outline discussed economic and financial conditions, social policies, and modernization of the national economy, which enabled the gradual transition in such a fast pace. As the characteristics of the Outline, three points can be pointed out.

- (1) The Outline mentioned, as the necessary economic and financial conditions, (i) ownership structure, (ii) price liberalization, financial and banking system, and currency, (iii) liberalization of foreign trade, and (iv) a new role of plans in the market economy. But it did not take up the macro economic stabilization problem. This is because, as will be discussed in Chapter 5, macroeconomic imbalance was not intangible at the onset of the transition in Romania, and the necessity of macro economic stabilization was not clearly aware of. But, considering pains in stabilizing the macro economy in 1990s, this ignorance is one of the issues.
- (2) On the contrary, many pages were devoted to the social policy to social costs that would be incurred in the transition process.
- (3) Many pages were also devoted to establishment of legal acts necessary for the transition. This is because the Outline optimistically thought that the laws could be

⁵ Outline(1990), pp.6-7.

⁶ Outline(1990), p.12.

established in a short period, and that the transition could be progressed only with establishment of the necessary laws.

Next, we will briefly look at how ownership structure (privatization), price liberalization, financial and banking system, currency, and foreign trade liberalization in turn. First, the Outline raised the necessity of privatization through selling state owned enterprises to private hands by auctions, selling stocks of commercialized state owned enterprises, establishing new enterprises, and leasing of state owned enterprises, so that autonomous decision-making by private economic units could be realized. However, the Outline proposed to keep important sectors remained in state owned, although it left the decision regarding what kinds of sectors are important to the hands of the government: the minimum variant (power generation, some mining industries, part of agriculture and forestry industries, transportation, communication, armament production, part of housing construction, health, education and social services), and the maximum variant (the minimum variant plus all mining sectors, metallurgy, machine building, chemistry, construction materials, and all the large-scale enterprise in other industries). These unprivatized enterprises were materialized as the "regie autonome" stipulated by the "State Owned Enterprise Reorganization Law" which will be discussed in Chapter 6.

As to the price liberalization, the Outline made following proposals.

- In the first quarter of 1990, prices of agricultural products and products of small enterprises and family plots should be liberalized. Also, state owned enterprises should be given greater authority for setting prices of some goods.
- Regarding with products of state owned enterprises, the Outline made two variants of proposals. The first one was to liberalize prices of 40 to 50 per cent of products on January 1st, 1990. The coverage of liberalized prices should be extended 80 to 85 per cent by January 1st, 1992, and after that all the prices should be gradually liberalized except daily necessities like basic foods, electricity, medicines, children's clothes, transportation fares, rents and so on. The second one was to liberalize prices of goods produced by more than one enterprises. And, prices of goods produced monopolistically should be negotiated within the upper limits settled by the government.

In both proposals, gradual price liberalization was proposed. Liberalizing all the prices at once was thought to bring confusions, because of huge discrepancy of the price system in Romania from the supply-demand relations and the world price system.

As to the financial, monetary and credit system, necessity of macro economic stabilization was not pointed out. The objects of the reform were:

- to transform the administrative allocation of financial resources to allocation determined by the supply-demand relations and economic efficiencies.

- to use state budget, monetary and credit system as a principal mean to lead entrepreneurs to the macro economic policies' objects.

Finally, regarding with the foreign trade, the Outline proposed to abolish the state monopoly, to revise the laws and regulations for treating all the entities equally, to limit import and export licenses and lists, and to introduce new custom system, so that Romania could be integrated into the European and world economy.

We might say that the proposals of the Outline were realistic, in the sense that the Outline thought the negative heritage of the Ceausescu era was so huge and that the objective was to minimize the social costs incurred in the transition process as much as possible. However, because of this gradualism, the Outline became criticized both internally and externally.

3 The Coordination Program

Although the Outline was prepared on the basis of the government decision, it was not adopted as the official economic reform program of the government. Another program, named the "Program of Coordination of Projects of Economic and Social Reform" was prepared, and it was approved as the official program of the government in August, 1990. After the election of May, 1990, the demonstrations for more democratic reform by the opposition parties including students were suppressed by coal miners. This led to suspend the official aid from the advanced countries. Petre Roman, the new Prime Minister, felt the necessity of a more radical reform program than the Outline, in order to resume he suspended official aid.

The Coordination Program contained necessary reform, legal frameworks, and measures which had ought to be executed from September, 1990 to June, 1992, in the domains of deblockage of economic structures, economic restructuring, price and tariff reform, reorganization of the financial and banking sectors, agricultural reform, creation of institutions supporting the economic reform, privatization, economic and social insurance, creation of culture and activities suitable to the market economy, and education of the market economy. The figure 4-1 shows a summary of 11 time schedules by sectors in the Coordination Program. We can point out the following characteristics of the Coordination Program:

- (1) The Coordination Program was more radical than the Outline, because in the Coordination Program it was intended to accomplish institutional and legal in about 640 days from September, 1990 to June, 1992. But it was more gradual than the Polish case, and close to the 500 days of Russia.
- (2) The price liberalization was not one-shot approach, because it was to be accomplished

by three stages with gradual abolishment of subsidies.

(3) As to the privatization, the voucher approach similar to the Russian one was proposed.

The main characteristics are:

- securities worth one third of the social assets of all the companies would be given to the people.
- people could exchange these securities with stocks of any companies to be sold in the future.
- workers would be given some preferences in buying stocks of their own companies.

(4) The macro economic stabilization was no more mentioned than in the Outline.

(5) Measures to social costs occurring in the transitional process were emphasized.

Both the Outline and the Coordination Program were worthwhile, because they showed the basic way of transition to the market economy and the time schedule for the implementation in Romania. However, the biggest problem common to these was a tendency to avoid the transition cost, although they admitted its necessity. The Outline stated as follows⁷.

“Transition to the market economy will make up for the social cost finally, when the first positive effect will appear later. We are not able to adopt such a strategy, owing to the factors specific to Romania. In a sense, the transition cost has been paid in advance in the abnormal and tragic ways. Remember the uneconomic and inhuman way to repay the foreign debt. ...The people hope that appropriate measures will be taken in order to a dignified and ordinary living standard and European level of culture.

The strategic idea below will show a guideline for compensate for the social cost when it will occur. Therefore, the basic social indicator comparable to the European average will be acquired not after the transition, but surely in the transitional period.

Similarly, the Coordination Program showed only the best strategy, saying that transition to the market economy would be achieved in one year and ten months. It, however, did not show any concrete transition costs such as the fall of the production, the inflation rate, the level of unemployment and so on. It did not also show the second or third best strategy.

The facts that both the Outline and the Coordination Program proposed the legal framework necessary for the transition, and that they did not propose any social cost of the transition incurred to the Romanian people produced exaggerated and easy expectation to the market economy. And these expectations caused confusion of the discussion in the parliament and between the people about, for example, the privatization process, and delay in implementing the law.

⁷ Outline(1990), p.12.

4 Comparison with the 500 days program

The official name of the 500 days program is “Transition to the market: concept and program”, also known as the Shatalin program⁸. It was prepared by the working group, organized by the consent of Gorbachev and Yeltsin, of the reformist economists like Shatalin, Yablinsky and Yasin in the summer of 1990. The 500 days program has some differences from the Coordination Program:

- It presupposed a reform of the socialist economic system in the Soviet Union.
- It was not adopted as an official economic reform program in the Soviet Union or Russia.

But it has also some similarities with the Coordination Program:

- It underlay the Gaidar reform starting in January 1992.
- The time span of the 500 days program was close to that of the Coordination Program.

It is beneficial to make a comparison between two programs.

First of all, the 500 days program consisted of four stages⁹. The first stage was the period of implementing the emergency measures from October 1, 1990 to the beginning of 1991. On the first day, it would be declared to introduce laws to set the basic principle of the economic reform. And by the end of the year, a set of laws for the marketization would be adopted. Also, in 100 days macroeconomic stabilization would be attained through the budget deficit cut and the banking system reform. The second stage was from the 100th day to 250th day, corresponding to the period from January, 1991 to the beginning of June, 1991. In the stage, prices would be liberalized and the monetary policy would be tightened. The third stage was from 250th day to 400th day, corresponding to the period from the beginning of June 1991 to October, 1991. In the period, a new economic relation would be arranged, through stabilization of consumer and production goods market and enlargement of the new economic relation. The fourth stage was the period from 400th to 500th day, corresponding to the period from November, 1991 to the beginning of February, 1992. In the period, the tasks were to reinforce the economic stabilization, and to foster the competitive market with a self-control mechanism. To achieve these, denationalization, privatization and demonopolization would be progressed and an industrial restructuring policy would be promoted.

The 500 days program made an explanation of policies that should be implemented according to this time schedule, *i.e.*, macroeconomic stabilization policy, competition policy, budgetary and financial policy, price policy, labor policy, trade policy, and structural policies including conversion, land policy, agricultural policy and so on.¹⁰

The biggest difference between Romanian and Russian programs is whether they took the macro economic stabilization into a consideration or not. The Coordination

⁸ Yablinsky, et al.(1991).

⁹ Yablinsky, et al.(1991), pp.31-45.

¹⁰ See Nishimura(1991), pp.264-267.

Program, as was noted above, did not refer to it, but the 500 days program said it was necessary to implement the macroeconomic stabilization policy of curtailing the budget deficit and banking reform by the 100th day. It also asserted that finance and monetary policies were basic policies. The difference occurred, firstly, because of the differences between initial conditions of the Romanian economic performance and those of Russia. In Romania, both the trade balance and the budgetary balance recorded surplus at the end of 1980s, because of the hasty repayment of the foreign deb. Therefore, the phenomenon of the excessive liquidity could not be observed in Romania, and there was little necessity to implement the macroeconomic stabilization policy. On the contrary, in Russia substantial excessive liquidity occurred in the latter half of 1980's, because of the budgetary deficit¹¹. In order to achieve successful transition, this excessive liquidity had to be managed at first. Also the new Romanian government could not suggest a new cost burden through the macro economic stabilization, because the social cost that the people paid in the latter half of 1980's by the rapid foreign debt repayment was big at all.

Secondly, the Coordination Program emphasized establishment of legal acts necessary for transition, whereas the 500 days program sought more concrete institutional building. We can say that the optimistic attitude in the Coordination Program, *i.e.*, the view that transition would be easily achieved once the legal acts are enacted, dominated in Romania.

Thirdly, in the Coordination Program consideration to the social cost incurred along with transition was substantial. This was also because the social cost that the people paid out in the latter half of 1980's was too big.

In a word, the Coordination Program was dominated by more optimistic attitude to transition than the 500 days program in Russia. In Romania this optimistic viewpoint to transition could have caused delay in coping with problems occurred and might have made the adoption of a hard landing strategy difficult, leading spiral occurrence of problems in the transitional period.

¹¹ Yoshii(1990).

Figure 4-1 The reform schedule of the Program

	Sep.-Oct., 1990	Nov.-Dec., 1990	Jan.-Mar., 1991	Apr.-Jun., 1991	Jul.-Dec., 1991	Jan.-Jun., 1992
Enterprise reorganization and privatization	reorganization of ministries					
	establishment of NPA					
	State owned enterprise reorganization Law					
	reorganization into RA and SC Corporation Law		Privatization Law			
	reevaluation of assets					
		transferring of 30% of assets to NPA				
		issue and distribution of certificates		exchange of certificates with stocks		
		issue and sale of stocks				
Agricultural reform	Land Law					
	scenario of agricultural reform		implementation of agricultural reform(privatization, reorganization)			
		← agriculture development program →				
Price reform, currency and convertibility	Price reform program					
			← price liberalization →			
		1st price liberalization		2nd price liberalization	3rd price liberalization	
		reduction of subsidies to state owned enterprises		abolishment of subsidies		
		regular devaluation to the level based on real purchasing power	denomination (1:10)	exchange of currencies		
		Foreign currency law				
			liberalization of payment in lei based on the unified exchange rate			
			-for non-residents	-for residents (within limit)	-for residents (within limit)	
Tax reform	budget law	1991 budget			1992 budget	
	accounting law					
	corporation profit law	income tax law	custom law	VAT law	Integrated income tax law	
Banking reform	banking law					
	reorganization of national bank as issuing bank, and		Establishment of new commercial banks			
	establishment of RCA, agriculture bank					
	cooperative bank, foreign trade bank					
		reorganization of CEC				