Romania's Adjustment after the Cold War

In 1991-92, the World Bank renewed its relations with Romania by approving two loans to finance emergency industrial imports and support free market reforms. An OED audit* of the projects found that the structural adjustment loan was successful, but that the loan for critical imports had very limited impact.

The Bank's persistence in upholding the basic principles of reforms through dealings with three consecutive governments proved essential to the modest success of the adjustment loan. In the case of the critical imports loan, insufficient attention to project implementation caused delays that reduced the loan's effectiveness. The experience highlights the importance of the timing and speed of reforms in adjustment lending and the appropriateness of lending instruments in tackling emergency assistance.

Shortly after the fall of communism in Romania, the new government launched a program of reforms to liberalize prices and establish the basic laws and regulations needed for a market economy. But price hikes linked to the program sparked protests that forced the government to resign, and a transition government was formed in September 1991. Following general elections in 1992, a new government committed to a slower pace of reforms assumed power.

During this crucial transition period, the Bank renewed its partnership with Romania by granting two loans. The first, approved in June 1991, provided emergency assistance by financing critical imports and technical assistance (TA) needed to prevent further collapse of Romania's production system.

The second loan, approved one year later and only three months before general elections, was a structural adjustment loan (SAL) in support of specific aspects of the country's reform program. The projects spanned two general elections, three different cabinet administrations, and the drafting of a new constitution.

Critical imports and TA

Import financing was provided only to those sectors considered economically viable in a competitive market economy, and only specific items were chosen for import. This part of the loan was complex and required contracts to be awarded through a variety of methods in seven industrial sectors and for a number of public enterprises.

Most of the funds for technical assistance were eliminated or transferred to other purposes because TA activities initially planned by the project were funded by other organizations. The Bank did maintain a central role in establishing an employment office to manage unemployment benefits and the transfer of workers into new jobs. The project also funded studies, purchased equipment for the statistics office and the railway company, and provided advice to the electric utility company and the mining industry.

Outcome

The loan provided some imports but failed to eliminate production bottlenecks and is unlikely to have long-term effects. The complex procurement procedures, the borrower's inexperience in preparing technical specifications, and the decision to fund only specific items caused considerable difficulties. Some of the imports were of questionable validity or came too late to be of much use.

Implementation management on the Bank's side was poor, and supervision of the procurement process was weak. As a result, it took five years to disburse the loan, and the borrower eventually ceased to view the loan as part of emergency assistance. The government now sees the loan primarily as a key element in building a new partnership with the World Bank and as a signal to the international community of the country's creditworthiness and willingness to undertake reforms.

The complex design of the imports component appears to have been

inappropriate for a country inexperienced in international procurement. An alternative lending instrument with simpler procurement procedures would have speeded up disbursement. One positive element of the project's design was its designation of some unallocated funds, allowing flexibility in distributing funds as needed.

**Structural adjustment**

*Stabilization.* Romania made little progress in stabilization until 1994, the last year of the project. The macroeconomic environment remains fragile because of interenterprise arrears and slow progress in the privatization or liquidation of insolvent public companies.

*Trade and price liberalization.* The loan was successful in promoting trade. Export restrictions were reduced drastically in 1992-93. Most price liberalization took place before the project, although the loan made a modest contribution to sustaining reforms.

*Subsidies.* The government eliminated most consumer subsidies. The loan helped reduce energy subsidies to consumers and producers and subsidies to enterprises from 22 percent of GDP in 1992 to 10 percent in 1994 and 7 percent in 1995.

*Privatization.* The loan achieved very modest goals in privatization, mostly involving retail shops, restaurants, workshops, and a few state-owned firms. The pace of privatization was either very slow or at a standstill during implementation but has since picked up. The loan provided a learning and piloting stage for the large-scale and massive programs unveiled later.

*Financial discipline and accountability in state enterprises.* By trying to eliminate interenterprise arrears, the loan aimed for a very ambitious and possibly unrealistic target, especially considering the lack of progress in privatization. Though the target was not met, progress was made in reducing arrears and in experimenting with alternatives to restore financial discipline. Without privatization, however, the sustainability of such discipline remains uncertain.

**Public sector reforms.** The loan supported two small elements of public sector reform: restricting the role of state enterprises to areas of strategic importance or natural monopolies, and initiating a systematic review of public investment projects.

**Outcome**

The structural adjustment loan played a relatively small yet significant part in the country's transition to a free market economy. The loan established fairly modest goals and was successful in achieving them, although it was unable to sustain the tempo of reforms because of the frequent changes in governments. The Bank maintained a steady and firm focus on the general lines of reforms when dealing with different governments, an approach that proved very important.

All macroeconomic indicators turned positive in 1994. However, structural reforms were not sustained and in 1996 were accompanied by an easing of monetary and fiscal policies. The new government elected in November 1996 was faced with a difficult and rapidly deteriorating economy.

By helping to privatize small firms and some public assets, the loan encouraged the government to attempt the privatization of larger companies. The loan also succeeded in improving the financial discipline of state-owned enterprises, but its benefits will last only over the short term. Long-term macroeconomic stability will depend largely on the privatization of large companies.

**Lessons**

- Privatization is more important than restructuring when trying to ensure financial discipline for long-term macrostability. Convincing clients to face hard choices, such as rapid large-scale privatization, should be a priority in adjustment lending. A slow approach may allow vested interests to retard the reform process.
- The design of the lending instrument must reflect its objectives. In the case of Romania, the Bank should have determined whether its procurement procedures were appropriate or whether they should have been modified to ensure timely availability of the needed imports, while maintaining accountability.
- Project implementation must have the same priority as loan approval. Proper implementation management and supervision might have prevented the delays that reduced the impact of critical imports.
- When dealing with changing governments, it is best to uphold the basic principles of reforms while remaining flexible about specific approaches, and to time reform programs to take advantage of maximum government support. As a result of delays in decisions on the government's SAL, and in the preparation of the structural adjustment loan, the project had to contend with a new government following general elections. Yet the Bank's strict adherence to the principles of reforms through several administrations contributed to modest success.