

# Recent Developments in Romania

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First of all, allow Mr. Urdea and me to extend our sense of gratitude and thanks to the Federal Reserve Bank of Kansas City for this great opportunity. Just last summer at this time, our participation in an international conference discussing radical reform of the economic and banking system of Romania was not only beyond our means, but frankly was beyond our dreams.

The program topic we are discussing now is very complex and I cannot afford to give a comprehensive treatment. I prefer instead to present to you some personal ideas on our concept of convertibility. And at the same time I will try to start with reforming the economic and banking system, not only in Romania but also in other Eastern European countries. We share the view that the different economic and political situations in Central and Eastern European countries require different approaches. Regarding the Romanian situation, we think that the only practical way for real transition from a command to a market economy should contain three cornerstones. First, we must dismantle the central planning institutions and their rigid control on prices, wages, and other economic variables, and put in their place the proper market institutions. In this respect, the radical reform of the banking system is essential in our view. Second, we must convert property and promote the private sector. Here the essential process is, in our opinion, the transformation of the state enterprise. Third, we must construct the social security safety net appropriate to a market economy mechanism. For Romania this is a particularly important point because the Romanian population suf-

ferred too much, especially during the last decade—the decade of madness—and we are very sure that any successful transition to a market economy depends on avoiding new suffering for the population of Romania. Regarding convertibility, we totally accept the concept presented by Mr. **Bergsten** and Mr. Williamson of current account convertibility and the importance of currency convertibility for the emerging Eastern European market economies. A good point made by the authors is that central planning was characterized not just by currency inconvertibility but also by commodity inconvertibility. I should add that in Romania this inconvertibility reached a real peak in the last couple of years of the former regime. Bank notes became more and more lottery notes. With luck and long lines, they were supposed to buy some goods—many times not exactly the wanted ones.

Our approach to convertibility is correlated with the general sequencing of economic and banking reform in Romania. I prefer the sequencing approach to either the big bang or the gradualism approach. For this, we must take account of Romanian priorities. Romania was the last Eastern European country, except Albania, to move toward democracy and a market economy. We started in December of 1989 with the most centralized and rigid economic system and with a real dictatorship. We then had a bloody revolution, which unfortunately was followed by six months of a political vacuum and social unrest. On the positive side of the Romanian revolution, I discovered that the disappearance of the Communist Party during the hottest day of December eliminated all the ideological obstacles we fought. There is a national consensus for democracy and a market economy. The new elected government is deeply committed to move rapidly in this direction.

What have we already done up to this moment? The State Enterprise Conversion Act was debated and passed months ago by the new Romanian Parliament. Accordingly, three quarters of the state enterprise became commercial companies, which are supposed to become fully privatized over a longer period of time starting perhaps this fall. The last quarter of the state enterprises, mainly the public utilities, became autonomous state-owned companies. Earlier, in March of this year, two other major bills were passed by the

provisional government. One permitted and promoted the setting up of new private entrepreneurs and the other relaxed tremendously the regulations on foreign investment in Romania.

What lies ahead in the near future? We are drafting bills regarding radical reform of the Romanian banking system—we put the assistance of the World Bank and the IMF in this field. We hope that the banking reform bills will be passed by the parliament no later than the end of this year. We are also drafting the bills on the social security safety net. Achieving current account convertibility of the Romanian currency is seen in this context of internal economic and banking reform. The specific institutions and the legal framework for convertibility will be created mainly by banking reform.

Additionally, we share Mr. Bergsten's and Mr. Williamson's view that introducing both commodity and current account convertibility in a related manner is a good idea. That is the reason we consider the State Enterprise Conversion Act to be critical. Our approach to convertibility, "rapid gradualism," is based on currency auctions and retention accounts. The legal framework for establishing retention accounts was already put in place by the State Enterprise Conversion Act and the Private Entrepreneurship Act. Under these laws, Romanian companies are allowed to retain **30** percent of foreign exchange earnings, and 50 percent as of next February. Perhaps we still need some technical qualifications this very moment. We are preparing the legal framework for foreign exchange auctions that we plan to hold twice a month starting in October of this year. Romanian companies that need hard currency will buy from those who have it. The exchange rate at the auction, in our opinion, will not affect (and we try not to affect) the official exchange rate or other commercial transactions.

Let me elaborate a little bit on that particular point, which was much debated by Romanian economists and benefited from IMF advice. In our opinion, both of these instruments have the potential, if utilized properly and on a temporary basis, for introducing a significant degree of liberalization in the trade and exchange system, paving the way for current account convertibility. I consider the following conditions necessary in order to realize this potential:

**For retention accounts:**

- (1) to provide a substantial retention level, at least 30 percent or perhaps 50 percent (this was a debated point);
- (2) to be nondiscriminatory, that is to apply equally across different branches of the economy; and
- (3) to exempt from the licensing requirements those imports that are financed by drawdowns from these accounts.

**For the foreign exchange auctions:**

- (1) to be considered a necessary complement to the retention accounts in assuring a more rational allocation of the scarce foreign exchange;
- (2) to avoid administrative restrictions on demand (for example, by limiting who can bid or the amounts of the bids), thus avoiding corruption;
- (3) to narrow the gap between the official and the auction exchange rates; and
- (4) to expand the auctions as quickly as possible with a view to using them as a key source of information for the establishment of a unified exchange rate.

Of course to achieve convertibility for the Romanian national currency, we need to continue what we already have started at the beginning of this year—that is, correction of substantial **overvaluation** of the national currency. We devalued tremendously one time, and perhaps we will devalue again this fall. At the same time, we need to establish an appropriate exchange rate regime. In my opinion, my personal opinion—this is debated up to now in Romania—this can be done by pegging to a basket of currencies, but I mean a very flexible pegging.