

## *What causes prosperity – Some evidence from Romania*

Being born in 1984, we are too young to remember concrete facts about the communist regime. We mostly know what we've been told and read about in our history books. Nonetheless, Orwell's novel seems far from utopian even for those of us who had the good fortune of spending only a few years living under collectivism. We can't help feeling shivers at every turn of the page.

That communism has done great harm is only an understatement. Proof resides in the countries in Eastern Europe that struggle still as "developing economies" even though many, like Romania, were relatively wealthy in the 1920s. Romanian society bears the mark of 40 years of communism even after the last decade and a half of sluggish transition to a market economy. After the initial euphoria with the fall of the communist regime, people found themselves in a world of political confusion and judiciary and economic chaos.

A thorough reform of the judiciary system was needed for the cornerstone of a free society. Unfortunately, only slight reform was carried out, in order not to interfere with special interest groups like former active members of the Communist Party and/or the secret services (the "Securitate"). They managed to become the "rulers of our newly formed democracy". As an example, a proposed law prohibiting former communist party members from holding positions in a political or public institution, didn't even get debated in Parliament, in spite of having great popular support.

Private property rights should have been a key starting point for a denationalization process. The 1991 Romanian Constitution protected private property, but did not mention anything about *guaranteeing the right to private property*.<sup>1</sup> Consequently, this was not enough to ensure former owners of getting their nationalized properties back. Moreover, in the early 1990s, the government sold the nationalized houses to the people who had rented them from the state. What followed was a period of "war" between former and present owners. Unfortunately, the former owners had little legal support due to the vague provisions of the Constitution and other land laws. The uncertainty over ownership stalled improvement of properties and investments and, with them, economic growth.

With the agricultural land, the situation was similar. Through the 1990 Land Law, the government started the process of denationalization by returning land (up to an amount of 10 hectares) to former owners, although not necessarily the same property earlier confiscated, nor even

---

<sup>1</sup> "Private property is protected equally by law, regardless of the owner. Foreign citizens and stateless people cannot gain property right on land" (41 st Article of the 1991 Romanian Constitution, The Protection of Private Property).

in the same area. As a result of the poor system of property rights, “by mid-1992, only 75 percent of the 5 million former owners had titles to their land”.<sup>2</sup> The absence of legal documents and the poor enforcement of the existing laws, prevented *reinstated* owners from exploiting the full potential of their assets. They couldn’t sell them, nor use them as collaterals for loans. As they didn’t have sufficient capital to invest in new crops or processing equipment, a great part of the fertile agricultural land became “dead capital”. This resulted in huge governmental imports of foodstuffs. Now, more than a decade later, we are pleased the Romanian government has learned from its previous mistakes. Unlike the 1991 Constitution, the present one (adopted in 2003) “guarantees private property and protects against state expropriation.”(44<sup>th</sup> Article of the 2003 Romanian Constitution, The Right to Private Property).

Denationalization remains an important issue even today and the Parliament is still working on improving the existing laws. There are a lot of cases waiting to be solved and some people turn to the European Court of Human Rights for help. They usually win the trials filed against the Romanian government.

Except for the judiciary, political and economic changes that have taken place over the past 16 years, there have also been major changes in Romanians' mentality. From a recently published book we have selected three quotes<sup>3</sup> that, in our opinion, depict this evolution.

***“It’s easier to work with state money than with your own. This is what everybody does. This is how businesses are done.”*** Doru Giugula<sup>4</sup>

This statement reflects the way most people perceived entrepreneurial activity during the first 5 years following the 1989 Revolution. As we mentioned, the chaotic legal and economic system allowed for “a random” process of privatization to take place. Thus, state-owned companies were sold to members of special interest groups (former members of the Communist Party, the secret services etc) under a total lack of transparency. This might explain why rich people were seen not as entrepreneurs that succeeded in the marketplace, but as individuals prospering through illegal activities. Although we cannot say that we have completely freed ourselves from such a mentality, it has become clearer that people have come to understand the principles of a market economy: a well-defined system of property rights, voluntary association and exchange, prices as a signalling

---

<sup>2</sup> Goodman, Sandra, “Lessons from a year in Romania”, <<http://www.fee.org/publications/the-freeman/article.asp?aid=4008>>

<sup>3</sup> The quotes can be found in a book written by a Romanian journalist, Radu Paraschivescu, called “May our transition be mild”. It gathers a selection of more or less hilarious media statements made by Romanian public figures over the last 16 years.

<sup>4</sup> Doru Giugula is a social-democrat counsellor of the Bucharest City Hall. The quote was taken from Radu Paraschivescu’s book “May our transition be mild”, page 21.

system between producers and consumers, competition as a “natural” selection process (without state intervention). The number of players in the market have risen not only from increased foreign investments, but also from a greater number of local businesses. All these changes were made possible through a series of market-oriented reforms: opening the borders, tax reforms that reduced the fiscal burden with a 16% income and corporate flat tax, and helped underground activities come to light, independence of monetary policy, and exposure to international trade and capital account liberalization (completed in September 2006). And all helped along by steadily diminishing red tape. In this regard, Romania’s overall rank in the Doing Business report of the World Bank, improved from 71 (in 2005) to 49 (in 2006).<sup>5</sup>

Romania’s development has also been influenced by its cooperation with international organizations, such as the IMF, the World Bank, NATO or the E.U. Collaboration with the IMF, for example, led to certain positive effects: receiving advice on the restructuring of the judiciary system, regaining credibility on the world market which, eventually, led to obtaining cheaper loans from international institutions. Also, the perceived country risk, gradually diminished due to IMF’s sometimes positive evaluation. Still there were plenty of disadvantages that resulted from this cooperation. As a condition for the loans it offered, the Fund imposed a variety of structural reforms (the reduction of trade and current account deficit, prudential fiscal policy, restructuring the banking sector etc) at once. This was, from the very beginning, the problem with IMF’s approach - the way of implementing its “top-down expert-driven plans”, known as structural adjustments, in the form of a “shock-therapy”.

In 2005, the IMF interrupted the stand-by agreement with Romania on the grounds that it didn’t follow the Fund’s suggestions for the fiscal and monetary policy. The most important issue of disagreement was on the introduction of a flat tax regime in 2005. The IMF forecasted a decrease in Romania’s tax income and, implicitly, an increase in its budgetary deficit. Despite IMF’s warnings, tax income rose by approximately 25%.<sup>6</sup> Economies are dynamic (apparently unlike IMF economists), and when taxes are lowered, enterprise and entrepreneurship naturally increase.

The next challenge Romania faces is joining the European Union club. According to some economists, this is the “big push” that our country needs in order to become a full-fledged market economy framed by a democratic society. Nowadays, everybody is talking about the benefits of integration, but they stand only at the level of the *seen*, as Frederic Bastiat would have put it. Few people consider the *unseen* in the trade-offs that will take place once Romania is part of the E.U. For example, the liberal policies that our government has adopted lately might have to be

---

<sup>5</sup> The criteria taken into account were: the ease of... Starting a Business, Dealing with Licenses, Registering Property etc. <<http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=158>>

<sup>6</sup> <[http://www.cdep.ro/proiecte/2005/400/90/7/leg\\_pl497\\_05.pdf](http://www.cdep.ro/proiecte/2005/400/90/7/leg_pl497_05.pdf)>

harmonized with the ones established in the social-democracies of the West. Harmonizing the fiscal policy is a main focus which could imply giving up the flat-tax regime. Also, joining the Common Agricultural Policy may strongly reduce the number of small and medium-sized companies because of the high level of regulation.

***“Everybody has the right to be richer than somebody else.”*** Gigi Becali <sup>7</sup>

Even though it may seem as a truism, we consider this statement to reflect a huge change in average Romanian mentality. The message it conveys is simple: within the legal framework, one can make use of one’s own assets. In other words, setting up a business and pursuing profit is not a revolutionary idea anymore. It has become common sense. Even students are encouraged, through various fiscal incentives (tax exemptions), to open up a business and many have taken advantage of this opportunity. We see such examples every month in university magazines that have special columns for students’ successful stories. The businesses range from producing clothing labels to web-design and data-entry.

***“Some believe that liberty has complicated many people’s lives. I think stupidity has done so.”*** Dorin Tudoran<sup>8</sup>

There are still those who long for the apparent safety provided by the past regime. Being comfortable with choices made by the totalitarian state, there are some people who perceive freedom as very complicated. We definitely agree that the market economy is complex and dynamic. It offers individuals an impressive array of choices but, at the same time, it requires personal accountability for their actions. It also creates the awareness that taking risks can lead to profits, but also to losses through the market mechanism. At the same time, the voluntary exchange system which the market economy is based on, allows economic agents to specialize in the fields in which they have a comparative advantage. This statement obviously applies to countries as players in the global market. Having this principle as a starting point, Romanian entrepreneurs are on their way to discovering those very areas in which they can perform better than foreign competitors.

---

<sup>7</sup> Gigi Becali, although not a very educated man, is one of the richest people in Romania. Owner of the largest football club, he has also run for presidency in 2004 and is intending to do so in the future. The quote was taken from Radu Paraschivescu’s book “May our transition be mild”, page 17.

<sup>8</sup> Dorin Tudoran is a Romanian poet and publicist, but also a political dissident. He is known for the written complaint he addressed Ceausescu on the 1<sup>st</sup> of August 1984 in which he stated: “...as a writer, citizen and parent I am completely convinced that between my beliefs on Man and Human Rights, Liberty and Democracy, Dialogue and Opinion, Culture and Education[...] and nowadays Romanian reality lies a deep precipice.”

Testimony to this is the development in recent years of fields such as textiles, footwear and, mostly noticeable, ecologic agricultural products (fruits, vegetables cultivated without chemical enhancements, traditional types of cheese etc.)

To conclude, prosperity is promoted by many factors and, although we mentioned only some, we tried to emphasize those that contributed most in Romania's case: less taxes and regulations.

As more experience economic freedom firsthand, many Romanians are comfortable, as we are, with the words of Johan Norberg: "My aim is freedom and voluntary relations in all fields. In the cultural arena, that means freedom of expression and of the press. In politics, it means democracy and the rule of law. In social life, it means the right to live according to one's own values and to choose one's own company. And in the economy, it means capitalism and free markets."<sup>9</sup>

#### **References:**

De Soto, Hernando "The Mystery of Capital", Basic Books, 2001

Goodman, Sandra, "Lessons from a year in Romania", <<http://www.fee.org/publications/the-Easterly>, William "Freedom versus Collectivism in Foreign Aid" in Economic Freedom of the World: 2006 Annual Report, 2006. <<http://www.freetheworld.com/2006/2EFW2006ch2.pdf>> [freeman/article.asp?aid=4008](http://www.fee.org/publications/the-freeman/article.asp?aid=4008)>

Lee, Dwight R. "Specialization and Wealth," The Freeman. 1998, August. <<http://www.fee.org/publications/the-freeman/article.asp?aid=3509>>

Norberg, Johan "In defence of global capitalism", CATO Institute, 2003.

---

<sup>9</sup> Norberg, Johan "In defense of global capitalism", CATO Institute, 2003, page 17