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Administrative Review
Public Document

MEMORANDUM FOR:	Joseph A. Spetrini Acting Assistant Secretary for Import Administration
THROUGH:	Jeff May Director, Office of Policy Albert Hsu Senior Economist
FROM:	Lawrence Norton Sirena Castillo Policy Analysts
DATE:	March 10, 2003
SUBJECT:	Antidumping Duty Administrative Review of Certain Small Diameter Carbon and Alloy Seamless Standard, Line and Pressure Pipe from Romania – Non-Market Economy Status Review

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SUMMARY

On October 1, 2001, the Department of Commerce ("the Department") initiated an antidumping duty administrative review of certain small diameter carbon and alloy seamless standard, line and pressure pipe from Romania. See Notice of Initiation of Antidumping and Countervailing Duty Administrative Reviews and Requests for Revocation in Part, (66 FR 49924, October 1, 2001).

On May 10, 2002, the Department received a letter from the Government of Romania ("GOR") requesting a review of the status of Romania as a non-market economy ("NME") country, either in a free-standing investigation or in the context of this administrative review. On September 10, 2002, in response to the GOR's request, the Department initiated an inquiry into Romania's NME status in the context of the instant administrative review.

Our analysis of Romania's economic reform results to date, as analyzed under section 771(18)(B) of the Tariff Act of 1930, as amended ("the Act"), indicate that Romania has successfully made the transition to a market economy. The currency is freely convertible and wages are market-based. While foreign direct investment ("FDI") has been relatively low, Romania is open to foreign investment. As a result of economic and institutional reforms undertaken in Romania since 1990, the private sector share accounted for at least 65 percent of GDP in 2001 and 75 percent of employment. There is a significant small- and medium-size enterprise ("SME") sector, which is the principal source of new jobs. SMEs account for about half of all employment and dominate many parts of the economy, including the service sectors and clothing, apparel, footwear and furniture industries. Almost all land is privately owned, and the legal system is in place to facilitate land transfers. While energy sector reforms are not yet complete, much progress has been made. Romania is a founding member of the World Trade Organization ("WTO") and is open to trade, with average applied tariff rates of 16.2 percent. Romania also has a trade arrangement with the European Union ("EU") and a bilateral investment treaty with the United States.

Despite these successes on the reform front, problems remain. The stock of enterprise arrears remains stubbornly high, and FDI is relatively low. On balance, however, the totality of Romania's economic reform results indicate that Romania's economy is now market-based. Therefore, based on the evidence on Romanian economic reforms to date, analyzed as required under section 771(18)(B) of the Act, we recommend that the Department of Commerce revoke Romania's NME status, effective January 1, 2003.

This finding will apply to all future administrative proceedings covering periods of investigation or review that fall after January 1, 2003. Where a proceeding's period of investigation or review begins before January 1, 2003, but ends after that date, the Department will use the standard market economy methodology if it determines that a sufficient period of time has passed so that adequate market economy data is available. In addition, the U.S. countervailing duty law will apply now to Romania where the proceeding at issue involves an adequate period of investigation after this effective date.

SUMMARY OF COMMENTS AND REBUTTAL COMMENTS FROM PARTIES

Parties Who Support Revoking Romania's NME status

In addition to the government of Romania, the Department has received comments supporting a revocation of Romania's NME status from Lockheed Martin, PricewaterhouseCoopers, Proctor and Gamble, Washington Group International, Harris Corporation, Trinity Rail Group, the Romanian-American Chamber of Commerce, Ispat Sidex, and S.C. Silcotub. The comments in support discussed the following issues in Romania:

1. The European Bank for Reconstruction and Development ("EBRD"), European Commission, the International Monetary Fund ("IMF"), and the World Bank have all applauded Romania's recent progress in reform.
2. Romania has not fully completed its economic transition, but its progress is comparable to or further than other countries whose NME status has been revoked.
3. The *leu* is freely convertible on all current account transactions, foreign investors are subject to equal treatment, and foreign investors are able to freely repatriate profits and dividends in foreign currency.
4. Foreign investment is permitted and encouraged in Romania, with large investments enjoying incentives and a streamlined administrative process.
5. Romania is committed to privatizing its remaining state-owned enterprises.
6. The European Union has recognized Romania as a market economy for trade remedy purposes since 1993, and has a free trade agreement with Romania.
7. Canada treats Romania as a market economy for purposes of anti-dumping investigations.
8. Wages are freely determined, and the right to collective bargaining is guaranteed.
9. Economy-wide real wages have been growing recently, in line with economic growth.
10. The banking system has been restructured, and privatization is at an advanced stage.

Parties Who Oppose Revoking Romania's NME status

Comments against revocation of Romania's NME status were submitted by several U.S. steel producers: Bethlehem Steel Corporation, National Steel Corporation and United States Steel Corporation ("Steel Group"), as well as from the Ad Hoc Committee of Domestic Nitrogen Producers. Their comments in opposition discussed the following issues below:

1. Romania's legal structure is undermined by inadequate enforcement and an inept judiciary.
2. For purposes of Romania's candidacy for EU accession, the EU does not consider Romania to have a "functioning market economy."
3. Wage rates are not determined by free bargaining between labor and management as labor unions and worker rights are restricted in practice.
4. Romania has a history of backtracking on its commitments to liberalization and privatization.
5. While there are few formal barriers to FDI, unpredictable changes in the regulatory system and a culture of state control keep investment levels very low.
6. Foreign investors are deterred by demands for bribes and by frequent targeting by tax authorities.
7. GOR still controls a large share of the industrial and banking sectors, and it is reluctant to privatize profitable SOEs and restructure unprofitable firms.
8. The government still controls some prices, particularly in energy, and the toleration of non-collection means that some customers pay nothing at all.
9. Property rights are undermined by a recent law that forbids restitution in kind in most cases for property seized during the Communist era.

10. The state-owned sector has been allowed to build up very high levels of arrears, which distorts wages, discourages privatization, and prevents the efficient allocation of resources.
11. The rule of law is undermined by an opaque legal process, rapidly changing regulations, widespread corruption, and a politically-influenced judiciary.
13. Widespread corruption has helped prevent the emergence of a market economy.

ANALYTICAL APPROACH

In making an NME-country determination under section 771(18)(A) of the Act, Section 771(18)(B) requires that the Department take into account:

1. The extent to which the currency of the foreign country is convertible into the currency of other countries;
2. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management;
3. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country;
4. The extent of government ownership or control of the means of production;
5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises;
6. Such other factors as the administering authority considers appropriate.

In evaluating the six factors listed above, the Department has recognized that it is not sufficient that a country's economy is no longer controlled by the state to treat the country as a market economy. See Notice of Final Determinations of Sales at Less Than Fair Value: Pure Magnesium and Alloy Magnesium From the Russian Federation, 60 FR 16440, 16443 (March 30, 1995). Rather, the Department considers whether the facts, as applied to the statutory factors, demonstrate that the economy is generally operating under market principles. To this end, Congress has provided the above listed factors which the Department must evaluate to determine whether, in the judgment of the Department, market forces in the country are sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis.

The reason for this analysis is that prices and costs are central to the Department's dumping analysis and calculation of normal value. Therefore, the prices and costs that the Department uses must be meaningful measures of value. NME prices are not, as a general rule, meaningful measures of value because they do not sufficiently reflect demand conditions or the relative scarcity of resources used in production. The problem with NMEs is not one of distorted prices, *per se*, since few, if any, market economy prices are perfect measures of value, free of all distortions (*e.g.*, taxes, subsidies, or other government regulatory measures). The problem, instead, is the price *generation* process in NMEs (*i.e.*, the absence of the demand and supply elements that individually and collectively make a market-based price system work).

The Department's evaluation of the statutory criteria does not require that countries be judged against a theoretical model or a perfectly competitive *laissez-faire* economy. Instead, the Department's determination is based on comparing the economic characteristics of the country in question to how other market economies operate, recognizing that market economies around the world have many different forms and features. Although it is not necessary that the country fully meet every statutory factor relative to other market economies, the Department must determine that the factors, taken together, indicate that reforms have reached a threshold level such that the country can be considered to have a functioning market economy.

The Department has carefully considered the facts and arguments presented by all of the parties who made submissions during this proceeding. In addition, consistent with the Department's practice in addressing prior market economy determinations, the Department has relied upon the expert evaluations of third parties such as the World Bank, the IMF, the EBRD, the Asian Development Bank, the Asian-Pacific Economic Cooperation and the Organization for Economic Cooperation and Development ("OECD").

OVERVIEW OF ECONOMIC AND LEGAL REFORMS

Romania is a medium-sized country in southeastern Europe of approximately 22 million people, with a relatively large agricultural sector and natural endowments of energy and timber resources. During the Soviet era, Romania had a centrally planned economy dominated by heavy industry. The state owned all property, and prices were set and resources allocated by the government. With the regional push towards democracy and free market economies at the end of the 1980's, Romania began to implement gradual changes to its economic system, beginning with price liberalization and state-owned enterprise ("SOE") privatization in 1990. Reforms proceeded slowly, and results were unsteady and uneven, due to macroeconomic instability, worker resistance to reforms, and government indecisiveness about reform objectives and the pace and sequencing of reforms. The first transitional recession, which cut almost 30 percent from gross domestic product ("GDP"), further complicated reform efforts.

In 1997, a new government announced far-reaching reforms, including fiscal and monetary restraint, a unified exchange rate, full currency convertibility on the current account, the commencement of large-scale privatization, the elimination of most remaining price controls, and a crackdown on soft bank loans to SOEs. The new fiscal and monetary restraint resulted in recession, which became worse in the aftermath of the Russian financial crisis, and reform momentum slowed, particularly with respect to large-scale privatization, industrial restructuring, and banking sector reform.

In 2000, the current government embarked on a renewed program of reforms. This has resulted in an accelerated privatization of the remaining SOEs, an enhanced legal infrastructure, banking sector privatization and consolidation, cost-recovery pricing in the energy sector, and macroeconomic growth and stability.

The following section discusses each of the six statutory factors for determining NME-country status and the current state of Romania's economy as it relates to each of those factors.

ANALYSIS OF SECTION 771(18)(B) FACTORS

Factor One. The extent to which the currency of the foreign country is convertible into the currency of other countries.

A country's integration into world markets is dependent upon the convertibility of its currency. The greater the extent of currency convertibility, for both trade and investment purposes, the greater are the supply and demand forces linking domestic market prices in the country to world market prices. The greater this linkage, the more market-based domestic prices tend to be.

A. Legal framework

The requirements for a convertible currency regime are established by *Regulation 3/1997 On Performing Foreign Exchange Operations*. Under this law, residents and non-residents may acquire any foreign exchange-denominated assets, open accounts in both foreign exchange and domestic currency with banks licensed to operate in Romania, and perform current-account foreign currency transactions freely and without restrictions.[1] The regulation does require licensing for certain capital account transactions, but *Circular 26/2001*, amending the regulation, describes a timetable for phasing out almost all of these restrictions between 2002-2004.[2] These regulations and circulars are issued by the National Bank of Romania, which is responsible for overseeing the financial sector and Romania's foreign exchange regime. The 1998 Statute on the National Bank of Romania assigns the National Bank sole jurisdiction over monetary and exchange rate policy, tasks the bank with regulating and licensing the commercial banking sector, and ensures its nine-member board is independent of the government.[3] The NBR does not carry out quasi-fiscal activities.[4]

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[1] *Regulation No. 3/1997* "On Performing Foreign Exchange Operations," Articles 3-4 (1997).

[2] Circular 26/2001 "Amending and Supplementing Foreign Exchange Regulation No. 3/1997 on performing foreign exchange operations" (2001).

[3] *Law No. 101/1998* "On the Statute of the National Bank of Romania" Articles 34-35 (1998).

[4] *Romania: Report on the Observance of Standards and Codes - Fiscal Transparency Module* (Washington, DC: International Monetary Fund, 2002), p. 5.

B. Developments in the economy

The Romanian currency, the *leu*, has been fully convertible for current account purposes since Romania assumed IMF Article VIII obligations in 1998.[5] Domestic and foreign companies and individuals are free to acquire, hold and sell foreign exchange, and foreign companies are free to repatriate capital and remit profits. The exchange rate is freely set by the forces of supply and demand in the interbank market, in which some 40 commercial banks licensed by the National Bank of Romania ("NBR") participate.[6] Firms and individuals (both foreign and domestic) can also freely exchange currency at foreign exchange houses.[7] While the central bank occasionally intervenes in the foreign exchange market to reduce volatility or an excessive appreciation of the *leu*, this does not alter the fact that the exchange rate is market-based.

The *leu* is also convertible for capital account purposes. However, due to concerns about capital flight and currency stability, there are some restrictions on capital account transactions. These are common in many market economies.[8] Furthermore, in line with Romania's efforts to integrate into the EU, these are being phased out. Most remaining restrictions deal with short-term capital flows. In 2003-2004 the central bank plans to liberalize: (1) operations in money market instruments and in current and deposit accounts conducted by residents with foreigners; (2) acquisition of foreign trade securities by residents; and (3) short-term loans between foreigners and residents. In 2007, upon hoped-for accession to the EU, the NBR will allow quotation of foreign securities on domestic capital markets and operations by foreigners in *leu*-denominated deposit accounts opened with resident financial institutions.[9]

Assessment of Factor

The *leu* is fully convertible into foreign currencies for trade purposes and convertible to a high degree for investment purposes, giving rise to supply and demand on the interbank market that determine the exchange rate. Limited currency controls remain to combat capital flight and are similar in nature to those maintained by other market economy countries. While these purely capital account controls may affect the supply or demand for foreign exchange, the underlying convertibility of the *leu*

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[5] *Romania: 2002 Article IV Consultation - Staff Report; Staff Statement, Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Romania*, (Washington, DC: International Monetary Fund, 2003), p.4.

[6] *Romania Country Commerical Guide FY2002*, (Washington: DC: US Commercial Service, 2002), p.38.

[7] *Annual Report on Exchange Arrangements and Exchange Restrictions* (Washington, DC: International Monetary Fund, 2002), p.766-771.

[8] For example, Mexico, Poland, Russia, and Malaysia also have capital account restrictions. See *Annual Report on Exchange Arrangements and Exchange Restrictions* (Washington, DC: International Monetary Fund, 2002).

[9] "Romania Finance: Timetable for capital-account convertibility" *EIU Viewswire,* August 2, 2002.

and, therefore, the resultant market-based nature of the exchange rate, remains fundamentally unchanged.

Factor Two. The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.

This factor focuses on the manner in which wages are set because they are an important component of a producers' costs and prices and, in turn, are an important indicator of a country's overall approach to setting prices and costs in the economy. The reference to "free bargaining between labor and management" reflects concerns about the extent to which wages are market-based, *i.e.*, about the existence of a market for labor in which workers and employers are free to bargain over the terms and conditions of employment.

A. Legal framework

Romania's *Labor Code*, the *Law on Trade Unions*, and the *Law on Collective Bargaining* establish the rights, obligations and guarantees of workers and employers that form both the basis for free bargaining over wages and other terms and conditions of employment. The EBRD and the OECD consider the *Labor Code* of Romania to be generally consistent with international practice.[10] Romania has ratified all seven International Labor Organization ("ILO") core labor conventions.[11]

Unions are free to organize, and employees are free to join them, as guaranteed by the Constitution and *Law 54/1991 On Trade Unions*.[12] There is a 1991 law, however, that stipulates a minimum of 15 employees as a precondition to forming a union.[13] The constitution guarantees the right to labor mobility, the right to collective bargaining, as well as the right to strike.[14] The law dealing with collective bargaining is *Law 130/1996 On Collective Bargaining Agreements.*[15] This law mandates collective bargaining in firms with over 20 employees, but allows for individual contracting agreements.

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[10] *Stability Pact, South East Europe Compact for Reform, Investment Integrity, and Growth, Entrepreneurship and Enterprise Development: Romania, Policy Review,* Organisation for Economic Co-operation and Development and European Bank for Reconstruction and Development, 2002, p .48.

[11] "Romania Risk: Labor Market Risk," *EIU Riskwire*, February 21, 2003.

[12] *Constitution of Romania,* Article 37. See also Musat & Asociati, Attorneys at Law, *Doing Business in Romania,* 2001, Chapter XI: Employment.

[13] "Romania Risk: Labor Market Risk," *EIU Riskwire*, February 21, 2003.

[14] *Constitution of Romania,* Article 25 "Freedom of Movement," Article 38 "Labor and the social protection of Labor," and Article 40 "Right to Strike."

[15] Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter XI: Employment, p.106.

Law 14/1991 On Salaries authorizes the minimum wage, which is valid nationwide and periodically set by the government after consultations with trade unions and employers' associations.[16] The existence of a single, nationwide minimum wage means that workers and employers in both private firms and SOEs are free to negotiate wages above this level as part of a individual or collective labor agreement.

B. Developments in the economy

There are two categories of wages in Romania. The wages of government employees are set by the *Statute of Civil Servants.*[17] For all other employees, including those employed in the private sector and in SOEs, wages are formed through individual or collective bargaining. In smaller firms, the worker and employer individually negotiate the terms and conditions of employment, and in larger firms collective bargaining is mandated by law.

Collective bargaining in the SOE sector has resulted in wages that have grown faster in recent years than in the private sector.[18] This has occurred despite the fact that most SOEs have been consistent money-losers.[19] While this practice potentially leads to distortions, it applies to a minority of workers overall and is not the result of governmental action or policy.[20] Indeed, excessive wage

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[16] *Department of Labor Request for Minimum Wage Information,* December 1997, available online at http://www.mac.doc.gov/eebic/dec97.htm.

[17] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.38.

[18] The lack of hard-budget constraints on the SOE sector continues to be one of the biggest areas of criticism by the IMF, particularly as this wage growth has come at a time of high tax and inter-enterprise arrears. The IMF is particularly concerned about a 43 percent minimum wage hike that took effect in January, 2003. As SOEs have traditionally based wages on multiples of the minimum wage, this raise could artificially inflate wages across the board. For its part, the GOR claims that this minimum wage hike is solely intended to mitigate the recent large increases in energy prices and will not result in broader increases in wages in SOEs. See *IMF Romania: First and Second Reviews Under the Standy-By Arrangement-Staff Report.* 9/2002 p.20. See also *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p 86, 89.

[19] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p 72.

[20] *Romania: First and Second Reviews Under the Stand-By Arrangement, Request for Waivers, and Modification of Performance Criterion - Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by the Executive Director for Romania,* (Washington, DC: International Monetary Fund, 2002), p 15-16. See also *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p 67.

growth in the SOE sector has occurred in spite of government efforts to limit or constrain it.[21] Further, the significance of the relatively high wages in the SOE sector is mitigated by the fact that over 70 percent of the workforce is in the private sector.[22]

Wages in Romania are low overall, but they vary across sectors and skill levels.[23] Wage variations to a large extent reflect the relative bargaining power of various groups of workers (*e.g.*, skilled vs. unskilled, workers living near economic growth centers vs. those living in more remote locations). For example, pay has outpaced inflation in the air transport and financial service sectors, where workers are among the highest paid in Romania, but it has fallen short in the education, health and public administration sectors, where workers are among the lowest paid.[24] Many firms find it difficult to retain skilled staff, who command high wages and have many job opportunities.[25] The relatively high wages paid to workers in many SOEs reflects their unions' high level of bargaining power and the weak budget constraints that SOEs face.

Freedom of movement is guaranteed by law.[26] However there is a lack of geographic labor mobility in Romania. Most city-dwellers are dependent on highly subsidized public housing, and it is difficult to find other subsidized housing in another location.[27] While the lack of labor mobility is an issue in Romania, it is a developmental question and not government-imposed.

Around 55-60 percent of the non-agricultural workforce is unionized; unions are strong and, fearing job losses, have often successfully resisted restructuring.[28] In fact, they are influential enough to negotiate wage increases.[29] Their power has waned in recent years, however, with the shift in

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[21] *Ibid*, p.15-16.

[22] *Romania: Selected Issued and Statistical Appendix*, (Washington, DC: International Monetary Fund, 2003), p.41.

[23] PricewaterhouseCoopers, *Business Guide to Romania 2001/2002,* p.24. See also *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.77.

[24] "Romania Risk: Macroeconomic Risk," *EIU Riskwire*, February 21, 2003.

[25] "Romania Risk: Labor Market Risk," *EIU Riskwire*, February 21, 2003.

[26] *Constitution of Romania*, Article 25.

[27] "Romania Risk: Labor Market Risk," *EIU Riskwire,* February 21, 2003.

[28] *Id*.

[29] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002). p.86, 89.

employment from large SOEs to private SMEs that are less likely to be unionized.

Assessment of Factor

Wage rates are market-based. Collective bargaining is the standard at larger firms, and individually negotiated employment contracts are the norm at smaller companies. Both result in wages that reflect bargaining between labor and management. Although the relatively high wages in loss-making SOEs are not economically justified, they apply to a small portion of employment overall. Furthermore, the variance of wages across sectors and the high mobility of the highly skilled suggest that wages are market-based. Wage arrears, a significant problem in many transition economies, are not a significant issue in Romania.[30]

Factor Three. The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.

Opening an economy to FDI tends to expose domestic industry to competition from profit-maximizing market-based suppliers, including the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.

A. Legal framework

The legal basis for foreign investment in Romania is *Law 241/1998 On Promotion of Direct Investment*.[31] Under this law and subsequent legislation, foreign investors are guaranteed national treatment, have free access to virtually all economic sectors, and are allowed to participate fully in privatizations. *Law 241* also guarantees against expropriation, allows investors to remit profits after taxes, permits foreign-owned companies to own land, and provides that foreign investors may choose their preferred court or arbitration body in case of dispute.[32] Foreigners may opt for portfolio investment or any form of direct investment allowed by *Company Law 31/1990*, which applies equally to foreign and domestic investors. The *Company Law* allows for a variety of partnerships, joint-stock

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[30]*Ibid*, p.68.

[31]*Law 241/1998 for the approval of Government Emergency Ordinance 92/1997 on the Incentive of Direct Investment* (1998).

[32]*Id*..

companies, and limited liability companies.[33] Most foreign investors choose to form limited liability or joint stock companies, and the process takes about three to six weeks.[34]

Foreign investments outside of a few natural-monopoly sectors are subject to a uniform licensing and registration system as specified by *Law 241*. Foreign investors are subject to the same procedures as domestic investors, there are no restrictions on foreign ownership shares or on the forms of investment, and there are no performance requirements imposed on foreign investors (unless the foreign investors has applied for special incentives).[35]

Law 332/2001 is intended to promote large investments, both foreign and domestic.[36] Under this law, investments over one million dollars in most fields (excepting finance, banking, and insurance) are eligible for special incentives. Such incentives include customs duty exemptions and income tax reductions and deductions. In return, foreign investors commit to remain in Romania for ten years or repay the value of their incentives.[37]

A. Developments in the economy

Romania is open to FDI in virtually all sectors, with the only restrictions applying to sectors such as energy and railways which are currently run by the state but which are being opened to foreign investment in stages.[38] The telecom market is now deregulated and the largest Romanian telecom service provider is foreign-owned; some state gas and electricity companies are now accepting foreign bids; and the government even hopes to sell the highly profitable state oil company (SNP Petrom) within the year.[39]

Despite Romania's openness to foreign investment, per capita FDI levels remain low. The biggest obstacle to FDI is Romania's unwieldy and inefficient bureaucracy. There are more than 1,800 often conflicting institutions subordinate to government ministries and agencies, and their capacity to

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[33] *Company Law 31/1990* (as amended) (1990).

[34] *Romania Country Commerical Guide FY2002*, (Washington, DC: US Commercial Service, 2002), p.13.

[35] Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter III: Investment Law, p.29.

[36] *Law 332/2001 Concerning the Promoting of Direct Investments with Significant Impact on Economy* (2001).

[37] Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter III: Investment Law, p.29.

[38] *Investment in Romania*, KPMG, 2002, Chapter 2.

[39] *Country Report: Romania* (London: Economist Intelligence Unit, 2003), p.18-19, 22. See also "21 Firms Interested in SNP Petrom Privatization," February 27, 2003.

implement government policy is weak.[40] The judiciary is inexperienced and overtaxed with the task of administering a host of new laws. The lack of transparency and consistency in the legal system offers locals with insider knowledge an upper hand. Tax authorities are also more likely to target foreign-owned firms, as they are more likely to be able to pay.[41]

Recognizing the bureaucracy's dampening effect on FDI, the government has recently instituted measures to improve the business environment. In 2002, the current government established the Romanian Agency for Foreign Investments, which is tasked with developing strategies for attracting FDI, such as proposing measures to simplify licensing procedures and reduce red tape.[42] To assist larger investors in navigating the current system, the government also created the National Council for Foreign Investment to assist investors of over $1 million, and the Office of Foreign Investment to coordinate between business and government for investors of over $10 million.[43] The government has also simplified tax regulations and reduced Romania's high payroll tax.[44] Certain regions within Romania are also seeking to attract FDI on their own, and local governments help expedite the business licensing and registration procedures.[45]

Investors are drawn to Romania by low wages, the high levels of education and knowledge of English, the fact that Romania is the largest economy in southeastern Europe, and because of Romania's proximity to western markets. Romania has recently seen small increases in FDI and has countered the regional trend towards lower FDI levels. Per capita FDI inflows into Romania increased from $47 in 2000 to $52 in 2001.[46] This encouraging trend continued in 2002, with the Economist Intelligence Unit ("EIU") forecasting a further rise to just over $55 per capita FDI in 2002.[47] Particularly attractive to investors is the high growth of the Romanian export industry (EU), which grew

[40] "Romania Risk: Government effectiveness risk," *EIU Riskwire*, February 21, 2003.

[41] "Romania Risk: Tax policy risk," *EIU Riskwire*, February 21, 2003.

[42] "Romania Regulations: Investors are offered incentives," *EIU Viewswire*, August 2, 2002.

[43] *Romania Country Commerical Guide FY2002*, (Washington, DC: US Commercial Service, 2002), p.25.

[44] "Romania Risk: Tax Policy Risk," *EIU Riskwire*, February 21, 2003.

[45] "Romania: Employer's paradise," *EIU Business Eastern Europe*, November 12, 2001. See also "Legal and Regulatory Risk," *EIU Riskwire*, February 21, 2003.

[46] *Foreign Direct Investment Database*, Statistical Annex of United Nations Conference on Trade and Development, available online at www.unctad.org. See also *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS* , (London: European Bank for Reconstruction and Development, 2002), p.189.

[47] "Romania Risk: Forecast Data," *EIU Riskwire*, February 20, 2003.

by 17.9 percent year-on-year to October 2002 despite the global downturn.[48] Most other countries in the region saw reduced per capita FDI inflows. Observers such as the EIU predict that foreign investment will continue to rise.[49]

Assessment of Factor

Romania permits all forms of foreign investment, *e.g.*, joint-ventures and wholly-owned companies, in virtually all sectors of the economy. Foreign investors are free to repatriate profits and capital and are protected from nationalization or expropriation. Recent tax reforms have made the business climate more investor-friendly, and it is now easier to register a company in Romania. The government also has in place numerous investment incentives. The positive effect on investor confidence and the business climate is demonstrated by the increasing FDI inflows into Romania in recent years, despite a global economic downturn.

Factor Four. The extent of government ownership or control of the means of production.

The right to own private property is fundamental to the operation of a market economy, and the scope and extent of private sector involvement in the economy often is an indicator of the extent to which the economy is market-driven. The two main areas of concern under this factor are the extent of enterprise privatization and of land ownership.

1. The extent and pace of privatization of enterprises

A. Legal framework

The 1990 Constitution guarantees the right to private property and to conduct enterprise. Privatization in Romania began in 1991 with *Law 58/1991*, which was amended in 1994 and 1995.[50] Although many smaller SOEs were quickly privatized, restructuring of larger firms lagged. The government replaced the 1991 law with *Emergency Ordinance 88/1997* to speed up the process.

The most current law governing privatization is *Law 137/2002 on the Acceleration of Privatization*, which modified and partially superseded the earlier *Ordinance 88/1997*. *Law 137* includes straight-forward provisions to encourage privatization of loss-making firms such as reducing

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[48]*Country Report: Romania* (London: Economist Intelligence Unit, 2003), p.34.

[49]"Romania: Country Risk Summary," *EIU Viewswire*, February 20, 2003.

[50]Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter IV: Taxation System, p.29.

the 180-day term for privatizations when various investors have shown interest; externalizing the social assets of firms, and the writing off of tax arrears for companies privatized in 2002.[51] *Law 137* also includes measures to facilitate the quick issuance of land titles to privatized firms and reduce uncertainties associated with unresolved ownership claims.

Law 506/2002 clarifies investors' post-privatization responsibilities to avoid confusion on the part of affected parties. *Law 506* was needed because previous laws were often vague or contradictory, and court challenges by aggrieved parties to privatizations became common. The law mandates that the governmental agency responsible for privatization, the Privatization Authority, monitor the performance of obligations by the buyer in share purchase agreements.[52]

B. Developments in the economy

The privatization of small- and medium-sized SOEs was largely complete by the year 2000.[53] The sale of larger SOEs has proceeded more slowly, due to the chronic losses, large debts, and high levels of redundant workers in these companies. Nevertheless, privatization progressed to the point where the private sector accounted for at least 65 percent of GDP in 2001 and for 75 percent of all employment.[54] Other sources indicate that the private sector share of GDP may have been even higher in 2001, accounting for 67.1 of GDP.[55] While SOEs retain a significant presence in a number of industries (*e.g.* machinery, pulp and paper, chemicals, and mining), the private sector dominates information technology, construction, tourism, shipyards, automobiles, rubber, cement, fertilizer, clothing, footwear, apparel, furniture, cosmetics and cleaners, glass and porcelain, food processing, and

[51] *Law 137/2002* "Law on Actions to Accelerate Privatization" (2002).

[52] One potential problem with Law 506/2002 is that it applies retroactively, potentially requiring prior investors to undertake new obligations. See Rubin Meyer Doru and Trandafir, "Post-Privatization Law's Retroactive Effect of Prior Investments," *The Romanian Digest*, September 2002.

[53] *OECD Economic Surveys: Romania Economic Assessment*, (Paris: Organisation for Economic Co-operation and Development, 2002), p.64.

[54] *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS*, (London: European Bank for Reconstruction and Development, 2002), p.188. While this 75 percent figure includes agricultural employment, SMEs alone accounted for 41 percent of all employment in 2000. See also *Stability Pact, South East Europe Compact for Reform, Investment Integrity, and Growth, Entrepreneurship and Enterprise Development: Romania, Policy Review*, Organisation for Economic Co-operation and Development and European Bank for Reconstruction and Development, 2002, p 64.

[55] *OECD Economic Surveys: Romania Economic Assessment*, (Paris: Organisation for Economic Co-operation and Development, 2002), p 66.

steel.[56] Private SMEs account for a large share of the non-agricultural private sector, and are heavily involved in services, food processing, and in export sectors such as textiles and footwear.[57]

2. Land Ownership

A. Legal framework

The 1991 Constitution of Romania establishes the right to private property, including the right to own land.[58] The constitution forbids foreign individuals from owning land in Romania, but legal entities, including 100 percent foreign-owned enterprises, may own land for the purposes of business.[59] The first law dealing with land privatization was *Law 18/1991*, which was modified by *Law/1995* and *Law/2001* to resolve restitution claims.[60]

B. Developments in the economy

The actual process of privatization of land has been difficult because of the conflicting goals of selling land to current occupants and returning land to those who were disenfranchised during the communist era. This has resulted in legal complications, with most land being privately held but with many occupants still lacking clear title.[61]

Law 10/2001 on Restitution takes important steps to consolidate firm property rights.[62] It sets as the basis for restitution shares in companies or money. This is an attempt to end the legal wrangling

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[56] State Department Memorandum "Answers to Commerce Questions," February 7, 2003.

[57] *Id*. See also *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p. 94-95.

[58] *Constitution of Romania*, Article 41 "Protection of Private Property".

[59] *Law 241/1998 for the approval of Government Emergency Ordinance 92/1997 on the Promotion of Direct Investment* (1997).

[60] *Early Warning Report Romania*, (Bucharest: United Nations Development Program, 2002) p.8-9.

[61] *Law 112/1995* allowed current occupants to purchase their properties from the State by a certain deadline if the former owners had not retaken the property The deadline was unrealistic as the Communist government had seized or destroyed many records, the local bureaucracy was opaque, and the judicial system quite slow. The price paid by current occupants for their properties was also well under true market rates, which led many occupants to buy their properties from the state for a pittance and then immediately resell them at much higher prices. See Rubin Meyer Doru and Trandafir, "Post-Privatization Law's Retroactive Effect of Prior Investments," *The Romanian Digest*, August 2002.

[62] *Early Warning Report Romania*, (Bucharest: United Nations Development Program, 2002) p.10.

over ownership that has overloaded the judiciary.[63] Despite these problems, the principle of private ownership of land has been firmly established in Romania for over a decade.

Assessment of factor

Romania's privatization program is reaching an advanced stage. The slow pace of privatizing the state's remaining stake in the industrial sector is due to the limited appeal of many of the remaining SOEs and not to a government policy to preserve state ownership or control over a SOE sector. Land privatization is largely complete, although some owners have not yet received formal titles.

Factor Five. The extent of government control over the allocation of resources and over the price and output decisions of enterprises.

Decentralized economic decision-making is a hallmark of market economies, where the independent investment, input-sourcing, output and pricing actions of individuals and firms in pursuit of private gain collectively ensure that economic resources are allocated to their best (most efficient) use. Prices in such economies tend to reflect both demand conditions and the relative scarcity of the resources used in production.

An important measure of government control over production decisions and the allocation of resources is the degree to which the government is involved in the allocation of capital. Given that banks are important allocators of capital, the degree to which the State exercises control over the commercial banking sector is an important consideration.

For purposes of this factor, the four main issues are: (1) the extent of price liberalization, (2) arrears, (3) the status of commercial banking reform, and (4) the degree to which individuals and businesses can engage in entrepreneurial activities.

1. The extent of price liberalization

A. Legal framework

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[63]The changing legal environment and the conflation of the issues of restitution and privatization have led to hundreds of thousands of lawsuits regarding land ownership. This, in turn, has prevented the evolution of a proper market for land. With so many claims outstanding and the laws shifting, it is risky to buy land under litigation. Only 60 percent of land titles are properly distributed, and half a million lawsuits have flooded the judiciary. Only considering claims filed under the newest law, of the 188,297 claims filed by February 2002, only 2268 had been resolved as of July 2002. *Early Warning Report Romania,* (Bucharest: United Nations Development Program, 2002) p.9. *See also* Rubin Meyer Doru and Trandafir, "Post-Privatization Law's Retroactive Effect of Prior Investments," *The Romanian Digest*, August 2002.

Government Decision 180/1990 authorized the "Outline Strategy for Market Economy Implementation in Romania".[64] This document proposed that prices should be liberalized gradually. Most prices were liberalized in three rounds: in September 1990, April 1991, and in September 1991.[65] After massive labor unrest, tacit price controls were reimposed, and eventually the government retreated from price liberalization with Government Decision 45/1994.[66] This decision imposed price controls on a large range of goods.[67]

It was only in 1997 that the previous government freed most prices through its "Hundred Laws" program, with agricultural products liberalized in February 1997, retail goods in March 1997, and fuel in September 1998.[68]

B. Developments in the economy

Most prices in Romania are liberalized, with about 14 percent of prices involving regulation in early 2001, consisting mostly of energy, housing, medicines, and some transport.[69] In recent years, the government has dramatically increased energy prices to the point where prices now are at global cost-recovery levels.[70] Enterprises paid over $40/tcm for natural gas in the first eight months of 2002.[71] The government has fixed the price of natural gas in real (constant dollar) terms to avoid energy prices being eroded by inflation.[72] Energy price reform has been implemented as part of a broader ongoing

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[64] Shobo, Keisou, *Transition to a Market Economy in Romania: Lost 90s?*, "Part II: Progress of Transition to the Market Economy in Romania," July 2002, available online at http://www.econ.kobe-u.ac.jp/yoshii/e/publication/Romeco4.pdf.

[65] *Romania: Selected Issues and Statistical Appendix* (Washington, DC: International Monetary Fund, 2001) p.9.

[66] *Id*.

[67] These included many food products, energy, metals, medicine, wood, transport, childcare, municipal services, and others.

[68] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.22-23. See also *Romania: Selected Issues and Statistical Appendix* (Washington, DC: International Monetary Fund, 2001) p.10.

[69] *Romania: Selected Issues and Statistical Appendix* (Washington, DC: International Monetary Fund, 2001) p.10.

[70] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.80.

[71] *Romania: Selected Issues and Statistical Appendix* (Washington, DC: International Monetary Fund, 2003), p.67.

[72] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.80.

government effort to reform the energy sector. Romania's monopoly energy companies (gas and electricity) have been restructured, and they are now in the process of being privatized. Termination of non-payers is increasing, and collection rates for energy-sector companies now exceed 80 percent.[73]

2. The level of arrears in the economy

A. Legal Framework

Business arrears are a concern because they distort the allocation of resources, ensuring that loss-making and inefficient firms can stay in business and absorb resources that would otherwise go to more productive entities. They also distort the price system by weakening the budget constraints that firms face.

Romania has a fairly modern bankruptcy law, which has aspects that some observers find comparable to Chapter 11 in the United States.[74] The basic law is *Law 64/1995*, subsequently modified and strengthened in 1997 and in 2002.[75] The law permits both liquidation and reorganization, although liquidation is the more common result. In the five years prior to 2002, about 35,000 bankruptcy proceedings were undertaken, with 70 percent resulting in liquidation.[76] The newest amendments to the bankruptcy law, which took effect in September 2002, make company directors personally liable for failing to initiate insolvency procedures within 30 days of a default. They also try to make reorganizations more feasible.

However, Law 64 does not apply to SOEs that have been subject to financial monitoring by the government, although the law does direct the government to restructure or liquidate such firms.[77] This monitoring procedure, at least temporarily, weakens for SOEs the hard budget constraint that private firms face. This exemption is the primary explanation for the arrears problem discussed below.

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[73] *Romania: 2002 Article IV Consultation - Staff Report; Staff Statement, Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Romania*, (Washington, DC, International Monetary Fund, 2003), p.31.

[74] See the World Bank Insolvency Database Project available online at http://www4.worldbank.org/legal/legps_bank/insolvency/index.html. *See also* PricewaterhouseCoopers/Linklater, *The European Restructuring and Insolvency Guide 2002-2003*, p.461.

[75] Law 64/1995, *Law Regarding Judicial Reorganization and Bankruptcy Procedure* as amended by Emergency Ordinance 58/1997 and Ordinance 38/2002 (1995).

[76] PricewaterhouseCoopers/Linklater, *The European Restructuring and Insolvency Guide 2002-2003*, p.461.

[77] Law 64/1995, *Law Regarding Judicial Reorganization and Bankruptcy Procedure,* Article 128 (1995).

B. Developments in the Economy

Most arrears in Romania are unpaid debts to the energy sector and to the government (taxes and social funds).[78] Arrears have hovered at around 40 percent of GDP over the past three years, although by the end of 2001 they had dropped slightly to under 36 percent of GDP.[79] While arrears are a problem for both private firms and SOEs, they are far less of a problem for private firms than for SOEs, particularly for a handful of large, heavily loss-making state firms.[80]

The toleration of high levels of arrears in SOEs can be understood as a substitute for direct subsidization in old industrial sectors where reducing losses would involve large and contentious job losses. As for partially state-owned firms, these are firms that are largely in the process of full privatization and managers have little incentive to restructure before privatization is completing and its accompanying hard budget constraints take effect.[81]

3. The status of commercial banking reform

A. Legal framework

An important measure of government control over resource allocations is the degree to which the government allocates capital/credit. Since banks typically are the primary allocators of capital, it is important to look at whether the government controls the banks, especially in a country like Romania where capital markets are underdeveloped. The original law that removed government control over banks was the first *National Bank of Romania Law No. 34/1991*, which set up a two-tiered banking

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[78] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.72.

[79] *Romania: Selected Issues and Statistical Appendix* (Washington, DC: International Monetary Fund, 2003), p.39.

[80] Fully private firms collectively account for about half of the dollar volume of arrears in Romania. However, this is misleading for at least two reasons. The first reason is the "knock-on" effect of unpaid obligations from SOEs to private firms. Private-sector suppliers to SOEs often are not paid or paid late. Thus through this "knock-on" effect private firms may then have no other choice but to accumulate their own arrears, and indeed, non-energy sector inter-enterprise arrears accounted for 29 percent of total arrears in mid-2001. Non-payment from SOEs to private firms, especially SMEs, is a major burden and a major cause of bankruptcies for SMEs. The second reason is that arrears are much less a problem for non-SOEs, when measured as a percentage of turnover, which is a gross measure of ability to pay. For fully private firms in 2000, tax and social fund arrears amounted to less than 3 percent of turnover, versus over 20 percent for fully and partially state-owned firms. Total arrears accounted for 14 percent of turnover at fully private firms, compared to 41 percent at fully state-owned firms, and 69-70 percent at partially state-owned firms. See *OECD Economic Surveys: Romania Economic Assessment*, (Paris: Organisation for Economic Co-operation and Development, 2002), p.69-70, and *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.20.

[81] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.69-70.

system comprised of the Central Bank and commercial banks.[82] This legislation was replaced by *Law No. 101/1998 on the National Bank of Romania*, which modernized the Central Bank, and *Law 58/1998 on Banking*, which regulates commercial banks.[83] These laws assign to the National Bank of Romania the standard duties of central banks in market economies, including the licensing of commercial banks, setting reserve requirements, prudential regulation, and supervision.[84] Once licensed, commercial banks may engage in any banking activities. *Law 83/1997* deals with privatization of state-owned banks.[85] This law allows foreigners to purchase state-owned banks and does not require the government to retain shares. The European Commission gives the Romanian government high marks on the legislation concerning the banking sector, that its laws are in a "high level of alignment" with the EU body of law required for accession, the *acquis communitaire*, the body of common rights and obligations which bind all the member states together within the EU.[86]

B. Developments in the economy

While Romania has had a two-tiered banking system since 1991, the vast majority of the banking sector remained in state hands throughout most of the 1990s, and restructuring did not begin until 1999, after several large banks became insolvent.[87] The government let these banks fail, set up an asset recovery agency, liquidated failing banks, and strengthened capital requirements. The process of restructuring has continued under the present government, so that by 2001, 55 percent of the banking sector was in private hands, a figure which includes 24 foreign-owned banks.[88] This last major state-owned bank, Banca Comerciala Romana, which alone accounts for a third of all banking sector assets, is in the process being privatized.[89]

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[82] The 1998 *National Bank of Romania Act* abrogated Law 34/1991 *On the National Bank of Romania*.

[83] See Law 101/1998 *on Statue of the National Bank of Romania* (1998) and the *Banking Act* (1998).

[84] Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter VIII: Banking System, p.75.

[85] Law 83/1997 for *Privatization of Commericial Banks in which the State is Shareholder* (1997).

[86] *2002 Regular Report on Romania's Progress Towards Accession* (Brussels: Commission of the European Communities, 2002), p.61.

[87] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.59.

[88] *Transition Report 2002, Economic Transition in Central and Eastern Europe and the CIS*, (London: European Bank for Reconstruction and Development, 2002), p.188.

[89] "Romania Finance: Banca Comerciala Romana Stakes for Sale," *EIU Viewswire*, January 27, 2003.

The commercial banking sector still does not provide effective intermediation between savers and investors, although private-sector lending was up by 35 percent in 2002 from a low base.[90] The banking system remains concentrated and weak. Total banking sector assets are under 30 percent of GDP, deposits are around 20 percent of GDP, and domestic credit just above 10 percent of GDP.[91] This places Romania well below most European transition economies.[92] The majority of loans have very short-term maturities, and SMEs face high rates of interest if they can borrow at all.[93] The reluctance of banks to lend to enterprises reflects the risk aversion of the banks' new owners and the relatively high return on government bonds.

The government still directly guarantees some bank loans, 90 percent of which it eventually honors.[94] However, the vast majority of these guarantees facilitate investment in infrastructure and defense, rather than support soft loans to industry.[95]

4. The degree to which individuals and businesses can engage in entrepreneurial activities

A. Legal framework

The right to free enterprise and private property is established in the Romanian Constitution and in the *Company Law*. Romania's commercial legal framework is based on the French model which provides for both a *Commercial Code* and *Civil Code*.[96] Romania's commercial code and supporting legislation contain the three key elements of any modern commercial code that supports free enterprise. Those are enforceability of contracts, bankruptcy, and the registration and operation of companies. Romania's bankruptcy law, most recently amended in 2002, is discussed in the section on arrears above.

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[90] *Romania: 2002 Article IV Consultation - Staff Report; Staff Statement, Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Romania*, (Washington, DC: International Monetary Fund, 2003), p.12.

[91] *2002 Regular Report on Romania's Progress Towards Accession* (Brussels: Commission of the European Communities, 2002), p.47

[92] "Romania risk: Financial risk," *EIU Riskwire*, February 21, 2003.

[93] "Romania Regulations: Banking Supervision is improving," *EIU Viewswire*, August 2, 2002.

[94] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.27.

[95] Ibid, p.51.

[96] *Law in Transition Report, Spring 2002*. (London: European Bank for Reconstruction and Development, 2002), p.65.

The current law dealing with contracts (also known as "pledge laws") is Title VI of *Law 99/1999*, which took effect in August 1999.[97] This law, written with the assistance of the World Bank, is a modern and extensive law aimed at securing commercial obligations.[98] The law applies to all civil and commercial contracts, and the range of property that can be secured is very broad. Since late 2000 there is a single national electronic registry for charges over property, and Romanian law provides for various enforcement mechanisms. According to surveys, the law is also effective in practice.[99]

The law dealing with enterprise is the *Company Law 31/1990*, modified in 1997.[100] Under this law, the following commercial enterprises can be created: general partnerships, limited partnerships, limited liability companies, joint stock companies, and limited joint stock companies. The law also allows foreign companies to set up branches or representative offices in Romania. *Law 26/1990* deals with the registration of companies.[101] Recently, registration became less cumbersome with the enactment of *Emergency Ordinance 76/2001*, which allows for the registration of a commercial firm at a single government office.[102]

While private enterprise has been allowed since the end of the communist era, the current government has given it more institutional support, particularly to SMEs. In January 2001, the government created the Ministry for SMEs and Cooperatives to reduce the market entry barriers for small business and help them find access to financing.[103] The government also established a State Guarantee Fund, under which SMEs can access credit from private banks, with the state assuming the risk of default.[104] There are also two laws intended to promote the SME sector through various

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[97] Law 99/1999 described in *Law in Transition Report, Spring 2002,* (London: European Bank for Reconstruction and Development, 2002), p.63.

[98] *Ibid,* p.65.

[99] *Secured Transactions Project: Analysis of the Current Secured Transactions Legal Regime in Romania,* European Bank for Reconstruction and Development, 2002.

[100] *Law 31/1990 The Romanian Company Law,* as amended by *Emergency Ordinance 32/1997* (1990).

[101] *Law 26/1990 Registrar of Companies' Law* (1990).

[102] *Stability Pact, South East Europe Compact for Reform, Investment Integrity, and Growth, Entrepreneurship and Enterprise Development: Romania, Policy Review,* Organisation for Economic Co-operation and Development and European Bank for Reconstruction and Development, 2002, p.34

[103] *Ibid,* p.14.

[104] *Ibid,* p.19.

customs exemptions and tax breaks: *Law 133/1999 on the Establishment and Development of SMEs* and *Government Ordinance 24/2001 On Taxation of Micro-enterprises*.[105]

B. Developments in the economy

With its well-educated, low-wage workforce and proximity to Western markets, Romania has gone from an economy dominated by large SOEs to one based on the private sector SMEs. In 2000, there were almost 400,000 active SMEs in Romania, and they feature most prominently in the export sector and services.[106] Agriculture is almost completely privatized and is now dominated by small farmers.[107] SMEs are also the primary drivers of Romania's rapidly growing exports. Starting from a low base at the start of the transition, the (largely private) service sector alone now accounts for over half of GDP.[108]

By 2000, the SME sector accounted for 57 percent of total employees in the private sector, and 41 percent of employees in the national economy.[109] Virtually all job creation in Romania in recent years has occurred in the private SME sector, with a net increase of 700,000 jobs between 1995 and 2000.[110] Most of these firms are small and newly established.

SMEs have become the main drivers of Romania's exports, reorienting production of Romania's natural comparative advantage in labor-intensive industries such as clothing and apparel, footwear, furniture. These three sectors accounted for 37 percent of exports in 2001.[111] These sectors also recorded solid double-digit export growth in the first ten months of 2002.[112] Heavy industry's

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[105] Musat & Asociati, Attorneys at Law, *Doing Business in Romania*, 2001, Chapter III Investment Law, p.22-23.

[106] *Stability Pact, South East Europe Compact for Reform, Investment Integrity, and Growth, Entrepreneurship and Enterprise Development: Romania, Policy Review,* Organisation for Economic Co-operation and Development and European Bank for Reconstruction and Development, 2002, p.27.

[107] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.66,94.

[108] *Country Report: Romania* (London: Economist Intelligence Unit, 2003), p.5.

[109] *Stability Pact, South East Europe Compact for Reform, Investment Integrity, and Growth, Entrepreneurship and Enterprise Development: Romania, Policy Review,* Organisation for Economic Co-operation and Development and European Bank for Reconstruction and Development, 2002, p.26.

[110] *OECD Economic Surveys: Romania Economic Assessment,* (Paris: Organisation for Economic Co-operation and Development, 2002), p.93.

[111] *Ibid*, p.91.

[112] *Country Report: Romania* (London: Economist Intelligence Unit, 2003), p.34.

share of exports is smaller and declining. In 2001, iron and steel accounted for just 7 percent of exports, chemicals under 2 percent, and fertilizers 1.5 percent.[113] Currently, 67.8 percent of Romanian exports are directed towards the EU.[114]

There has also been a remarkable shift in employment patterns in Romania since 1995. The SOE-dominated large enterprise sector has shed 1.5 million jobs and contracted by 789 firms since 1995.[115] Meanwhile, there has been a net loss of 21,000 tiny retailers (of 1-9 employees, mostly household or kiosk operations) as retail has shifted into slightly larger operations. Growth has come mostly in enterprises employing between 10-249 workers, with a net creation of almost 18,000 firms (most of which are at the smaller end of the spectrum). These SMEs, involved largely in services and light manufacturing, created virtually all of the new jobs in the post-1995 period.[116] This is crucial because such firms provide most of the dynamism in market economies.

<u>Assessment of Factor</u>

The government no longer controls allocations of resources or prices beyond those goods that are subject to government regulation in some market economies, such as housing and transport. Even the price of energy (electricity and gas), which in the past was a significant distortion in the economy that led to inefficiency, has recently been increased to global cost-recovery levels. The pace of industrial restructuring of large, money-losing SOEs has been relatively slow, but Romanian firms and individuals are nevertheless allocating labor and resources to new and growing business opportunities in labor-intensive industries such as clothing and apparel, footwear, furniture, and Information Technology. As a result, there is now an SME sector of significant size and Romania's economy has restructured according to Romania's natural comparative advantage.

The government is not the primary allocator of capital in the economy, although it does guarantee some bank loans, primarily for infrastructure and defense investment projects. The banks are growing in their role as financial intermediaries, but the level of financial intermediation remains relatively low. As a result, most investment is self-financed, financed through informal channels, or financed with foreign funds. Thus, a market based capital allocation system exists, albeit a rudimentary and inefficient one.

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[113] *OECD Economic Surveys: Romania Economic Assessment*, (Paris: Organisation for Economic Co-operation and Development, 2002), p.92.

[114] *Country Report: Romania* (London: Economist Intelligence Unit, 2003), p.5.

[115] *OECD Economic Surveys: Romania Economic Assessment*, (Paris: Organisation for Economic Co-operation and Development, 2002), p.93-95.

[116] *Id*.

While some market distortions and resource mis-allocations characterize most market economies, the relatively high level of arrears in Romania remains a concern. However, the arrears problem (measured in terms of arrears as a percentage of turnover) is primarily an SOE problem. And in the SOE sector, the arrears problem, at least in the case of energy payments, is concentrated among a small number of companies that are chronic, heavy money-losers. It is not a systemic problem outside the SOE sector, where firms continue to face hard-budget constraints, as evidenced by the large number of SOE bankruptcies.

Factor Six. Such other factors as the administering authority considers appropriate.

Under this factor, the Department can address any additional issues relevant to its consideration of market economy status. A number of economic reform issues raised by the commentators do not readily fit into any of the preceding five factors and are addressed here. These issues include trade liberalization, rule of law and corruption.

Weak rule of law

As discussed in several of the preceding sections, the rule of law is relatively weak in Romania. This can be attributed to several factors: the law-making process is not transparent, the legal structure is vague and changes frequently, and the judiciary is unpredictable and not fully independent.[117] Successive governments have been apt to govern largely through "Emergency Ordinances," which effectively bypass parliament and can literally bring changes to the business environment overnight.[118] There are also laws in which the rights and obligations of individuals or firms are unclear.

With an opaque and confusing legal process combined with rapid shifts in laws, it is perhaps unsurprising that the judiciary has problems understanding and enforcing the current legal system. There is also a widespread perception of political influence in the judiciary. Reports have included the poorly-explained removal of judges, admonishments by the executive on the judiciary, and politicization of the anti-corruption drive.[119]

[117] *Early Warning Report Romania,* (Bucharest: United Nations Development Program, 2002) p.6, 9.

[118] Hulea, Dan, "Foreign Direct Investment Law in Romania-An Overview " *NYSBA International Law Practicum,* Autumn 2002, Vol. 15, No. 2, p.125-126.

[119] *Early Warning Report Romania*, (Bucharest: United Nations Development Program, 2002) p.7.

Corruption

Some commenters have asserted that corruption in Romania is pervasive and undermines Romania's claim that it is a market economy. The Department recognizes that corruption is a serious issue. Although we find the level of corruption to be a matter of note, it does not alter the fact that prices and costs in Romania are being generated through market forces. Moreover, we note that even in market economies, there exist varying degrees of corruption. According to one index, although Romania registers high levels of perceived corruption, it is no higher than levels for a number of market economies.[120]

Trade Relations

Romania is a founding member of the WTO, and its economy is generally considered open to trade.[121] Romania has a Bilateral Investment Treaty with the U.S., a trade agreement with the EU, and is a member of the Central European Free Trade Area. Romania's imports and exports have recently both been growing rapidly.

ANALYSIS AND ASSESSMENT

Although section 771(18)(B) of the Act enumerates six factors that the Department must consider in determining whether a country operates on market principles, the statute provides no direction or guidance with respect to the relative weight that should be placed on each factor in assessing the overall state of the economy. As discussed above in the "Analytical Approach" section, the Department considers whether the facts, as applied to the statutory factors, demonstrate that the economy is generally operating under market principles.

In the case of Romania, there are many positive developments that support the conclusion that Romania has a market economy. The exchange rate is no longer set on an administrative basis. Although currency controls are in place to limit capital flight and volatility, and the NBR actively intervenes in foreign exchange ("FOREX") markets to smooth the exchange rate, this is something that many central banks do around the world. These government actions do not alter the fact that the *leu* is fully convertible on the current account. Wages are market-based and reflect the relative bargaining power of labor and management, which vary with local market conditions and the industry sector in question. Romania is open to foreign investment, and although FDI inflows have been relatively low, the government has taken action to improve the business environment, with positive results. The government no longer controls the vast majority of prices, and markets now allocate resources and determine output in Romania. The SME sector has grown to a significant size and accounts for virtually

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[120] *Corruption Perceptions Index 2002* (Transparency International, 2002) online at www.transparency.org.

[121] "Romania Risk: Foreign Trade and Payments Risk," *EIU Riskwire*, February 21, 2003.

all job creation. While privatization of the largest SOEs has been relatively slow, its pace is increasing and the government's stated goal is to sell off all its remaining shareholdings. Trade has been fully liberalized and Romanian markets and prices have become closely linked with Western Europe. Romania is a founding member of the WTO, both its exports and imports have been growing rapidly, and the vast majority of its trade is with Western market economies.

Arrears are high, but falling, and as measured as a percentage of turnover are heavily concentrated in the SOE sector. Thus, arrears concern a dwindling share of the economy and do not take away from the fact that markets – private capital, private property, private initiative, and increasingly clear, stable and well-defined rules – now control resource allocations and Romania's economy. Thus, market forces within Romania have developed sufficiently that, in general, the Department may use prices and costs within Romania for purposes of its antidumping analysis.

RECOMMENDATION

Based on the preponderance of evidence related to economic reforms in Romania to date, analyzed as required under section 771(18)(B) of the Tariff Act of 1930, as amended (the Act), we recommend that the Department treat Romania as a market economy for the purposes of antidumping and countervailing duty proceedings.

Agree________   Disagree________

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Joseph A. Spetrini
Acting Assistant Secretary
for Import Administration

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Date