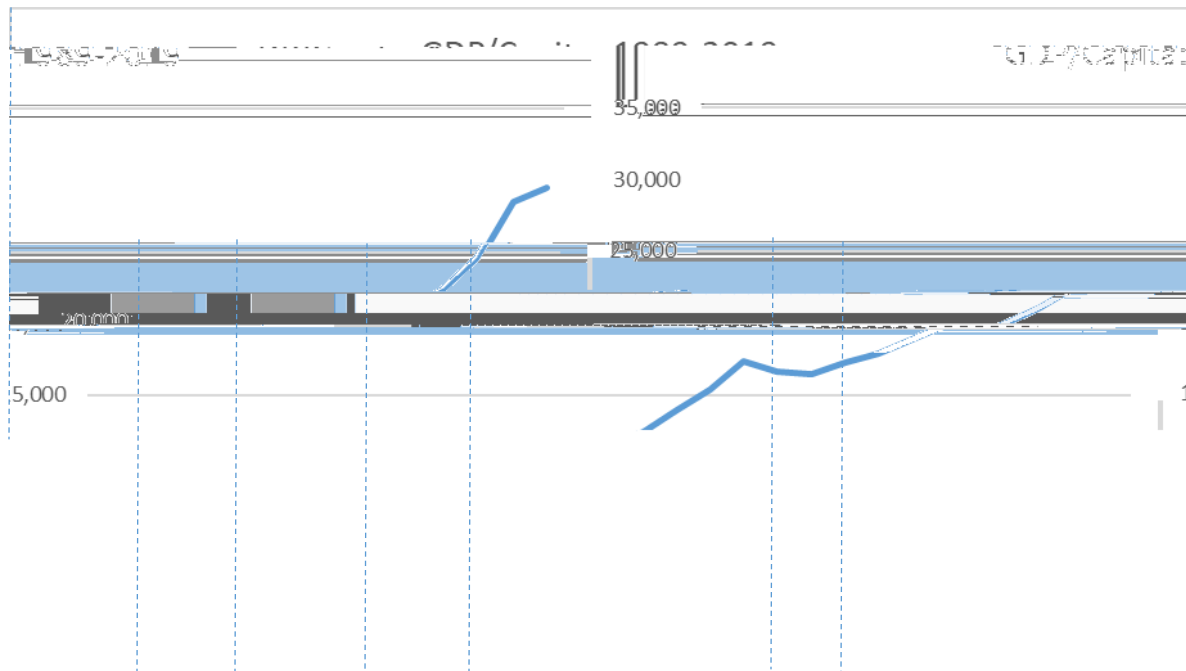




In 2019, Romanians had their 30-year anniversary of the fall of communism in 1989, and there was much to celebrate. However, there is also still much to be done. As we can see in Figure 1 below, Romania has accomplished a great deal economically, but not without some significant setbacks along the way. While at first, the economy declined sharply as per capita income and production fell from \$7,486 in 1989 to a low of \$6,177 in 1992, it later recovered to \$8,075 in 1996. As we can see, the transition had a rough start with the economy only getting back to the level under communism in 1995.

Figure 1



Source: International Monetary Fund

All of the Eastern European countries that had been dominated by (or directly absorbed by) the Soviet Union suffered rocky starts when they moved from state owned and controlled economic systems to free or open ones. Some had rockier starts than others had due to both different initial conditions and to different policy paths chosen to get to an open economy. As to initial conditions, on the positive side Romania had virtually no external debt to repay due to the draconian policies of the communist Ceausescu Regime. On the negative side, Romania is farther east (and therefore farther from Western markets and investors) than other transition economies like the Czech Republic or Poland that had borders with European countries like Germany or Austria. Overall, a neutral start.

The real problem for Romania's early transition was the choice of economic policy. At the time, two major, and competing, theories of transition were in play. One plan, "Shock Therapy", postulated that to make a successful transition from a centrally planned government-owned system the new government would need to make a dramatic choice to immediately privatize all state-owned industry, remove all price controls, open the country to foreign competition, and remove all subsidies to both firms and consumers. The idea was that without a complete change to the

system there would always be a strong temptation to go back to communism when the going got rough, and therefore no real reform would be forthcoming. Pitted against the bracing “Shock Therapy” plan was the idea of gradual transition, where most of the government owned firms would remain in state hands and the conversion to a market system would be phased-in over several years