Institutional Capture in Transition: Business, Market Governance and High-Level Corruption in Romania, 1999-2007

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Introduction

Romania's economic and reform performance in the last seven years has been surprisingly robust, especially if viewed from the vantage point of the economic and political situation of early in the year 2000. GDP growth has been spectacular for a European country, exceeding 5% every year since 2001, except for 2005, when it was 4.1%. The business environment has improved considerably in many areas, including dealing with licenses, employing workers, getting credit, protecting investors, trading across borders and closing a business (World Bank 2006: 2), and economic reform indicators from the European Bank for Reconstruction and Development (EBRD) also show marked improvement in many areas in the last few years. This is in spite of considerable concern in the first decade of transition that communist-time managers were able to gain long-term advantages and to prevent restructuring through institutional capture, by opposing the creation of market rules that would level the economic playing field.

More difficult initial conditions than in Central Europe and reform choice (gradual) based on political continuity of left-leaning party resulted in slower progress of economic reform and transformation of the economy in Romania than in the frontrunners. However, with the opening of accession negotiations to the EU in December 1999, the pace of reform increased considerably. Creating the institutional framework for a functioning market economy was considered a critical second phase of economic reform, and a key follow-up for initial liberalizing reforms (price liberalization, macroeconomic stabilization and privatization) (Stiglitz 1999, Svejnar 2002). Institutional reforms were

considered necessary to avoid the entrenchment of the early unfair advantages that nomenklatura-related economic agents were able to acquire as a result of the initial reforms. At the same time, these institutional reforms should have been hard to realize, given that these early winners gained from partial reform, and thus had an interest in preventing further reform (Hellman 1998). The EBRD warned in 1999 that narrow vested interests "often gain from the market distortions and corrupt practices associated with partial reforms" and argued that increased political and economic competition is essential to continued reforms (EBRD 1999: 102).

In this paper, I investigate how Romania was able to avoid the trap of partial reform in spite of the anticipated opposition of vested economic interests. Institutional capture by business, defined as the ability of powerful economic actors to create laws and institutions that protect their advantages and that allow for their continued enrichment and power, has not come to pass in Romania. Instead, a market governance institutional framework approximating that of advanced capitalist countries has been put in place. I argue that the main explanations for these recent market governance reforms, namely international influences and structural economic change in response to crisis, are insufficient for explaining why perceptions of institutional capture by business have improved. The main factor influencing this perceived drop in institutional capture is not so much the advancement of institutional reforms in the market domain, but rather the significant advances in the privatization process, especially to foreign investors. Once a critical mass of significant economic assets was sold by the state (often to foreign investors), a key need for business to prey on the state has disappeared. This does not mean that high-level corruption in the economic domain has disappeared, but rather than

seeking to influence the main rules of the game, business now try to obtain particularistic advantages, such as contracts with the state, or temporary exemption from regulations. The need for foreign investment, both due to a lack of domestic capital and to the political imperatives of accession to the EU, has prompted the government to sell many valuable assets to foreign companies, who needed sophisticated market institutions. Contrary to legacies arguments, the Romanian business people that survived in this market environment did not oppose the perfecting of the institutional framework either, and have adapted to these sophisticated rules.

The idea that inequality is institutionalized through setting the rules of the game in one's favor is a favorite explanation in institutionalist comparative politics. Douglass North (1990) has advanced our theoretical understanding of this idea by using the concept of path dependence to explain why inefficient institutions can persist in time, leading to wide differences in the economic performance of various countries. Institutional capture is therefore potentially one of the practices most harmful to economic development. I focus here on the ability of vested interests to prevent important institutional reforms that concern market governance rules (e.g. corporate governance, contract, bankruptcy, competition laws). We still don't have a theory of the evolution of the influence of vested interests on politics or the economy in transition countries, and cannot predict what path this influence will follow in particular countries. This is why process-tracing in Romania, an unlikely case of diminished influence of business interests, can be extremely useful in identifying the conditions under which improvements in governance and the business environment can occur, and the influence

of 'early winners' can be neutralized. This study follows the logic of the least likely case design.

The state of institutional reforms and institutional capture in Romania

Legacies-inspired arguments claim that initial policy choices were vital for the ability of a government to pursue further reform, because economic and institutional reforms are path-dependent: early choices have disproportionate influence on outcomes by foreclosing certain paths initially open; later choices matter less, because they cannot change the path already chosen. The EBRD (1999: 102) noted that "where initial policy choices have concentrated economic power in particular groups, this power has been used to distort or stall reforms later in the transition". Romania, together with Bulgaria, Ukraine, Russia and many other countries east of the Central European frontrunners, were believed to have made the wrong initial choices (ibid: 106). In 1999, the first EBRD survey of business perceptions suggested that the influence of vested interests through state capture was substantial in Romania. State capture was defined as "*the efforts of firms to shape the laws, policies, and regulation of the state to their own advantage by providing illicit private gains to public officials*" (Hellman and Kaufmann 2001). This strategy of individual firms was believed to create a systemic trap in some countries called high-capture economies, where political connections of a firm are rewarded more than innovation, creating a vicious circle in which private firms strive on state capture (ibid.). Path-dependence would thus lead economies like Romania's into a low-performance equilibrium.

This gloomy perspective has not come to pass. Enterprise surveys and the evolution of market governance institutions in Romania (but also in other countries to the East) show that the evolution of the two apparently-related issues of state capture and institutional reforms has been contrary to expectations of the path-dependency view. State capture has declined and institutional reforms have advanced substantially. Romania's economic performance since 2000 has been impressive on many counts. GDP average growth rates have been higher than 5%, raising the standard of living, measured in GDP per capita, more than three times since 2001, and prompting the IMF to call Romania the fastest growing EU economy (IMF 2007). Inflation and unemployment have dropped, inflows of FDI have taken off, investment as a share of GDP has risen from 16.1% in 1999 to 22.7% in 2005, and non-performing loans have dropped as a share of total loans from 35.4% in 1999 to 1.8% in 2006 (EBRD 2005, 2007). The share of population living in poverty has declined from 30% in 1999 to 12.9% in 2003 (EBRD 1999, 2007).

The EBRD transition scores also reflect marked improvements, in spite of Romania's transition score in 2007 still being the lowest among Eastern European EU members. The evolution of Romanian economic reforms shows some intensification in the year 2000, when the negotiations with the EU for accession start. The main change in the early 00's was the intensification of large-scale privatization. 2004, the year that EU accession negotiations were finalized, and an election year, again sees sustained reform progress. Reforms continue also after the 2004 elections, bringing Romania closer to the EBRD reform scores of Central European countries.

EBRD reform indexes for Romania 1998-2007

	Large-scale privatization	Enterprise reform	Competition policy	Banking sector reform	Infrastructure reform	Romania/ CEE-EU members average
1998	2.67	2.00	2.33	2.33	2.67	84.3%
1999	2.67	2.00	2.33	2.67	2.67	84.1%
2000	3.00	2.00	2.33	2.67	3.00	86.3%
2001	3.33	2.00	2.33	2.67	3.00	85.8%
2002	3.33	2.00	2.33	2.67	3.00	84.2%
2003	3.33	2.00	2.33	2.67	3.00	83.0%
2004	3.67	2.00	2.33	3.00	3.33	87.4%
2005	3.67	2.33	2.33	3.00	3.33	87.1%
2006	3.67	2.67	2.67	3.00	3.33	90.4%
2007	3.67	2.67	2.67	3.33	3.33	92.0%

* These measures are on a scale of 0 to 4.5. Source: EBRD Transition Indicators http://www.ebrd.com/country/sector/econo/stats/index.htm and author's calculations.

Another important way of looking at Romania's reform progress is firms' perceptions of the business environment, measured by the EBRD and the World Bank in 3 successive waves of BEEPS (Business and Enterprise Economic Performance Survey). Romania's performance in the business environment improved steadily from a very low base. In 1999, firms rated the business environment quite poorly. State capture, measured as the sale of parliamentary votes to private interests, had a very significant or significant impact on 22.3% of firms, which made Romania a high-capture economy (Hellman et al 2000). In contrast, in 2002 only 4.4% of firms declared they were affected by state

capture in a decisive or major way (World Bank 2002)[1]. This is a major drop in perceptions of state capture, which I will explain in this paper. The decline of the state capture measure has been accompanied by improvements in other dimensions of the business environment: macroeconomic instability, tax rates, and cost of financing, while issues like functioning of the judiciary have seen smaller improvements from low bases[2], and tax administration and labor regulations are actually perceived to have worsened (World Bank 2005). With some exceptions, this perception of improvement in economic governance (measured across the dimensions of judiciary, crime, corruption, customs and trade regulations, business licensing and permits, labor regulation and tax administration) runs across Eastern Europe, suggesting that Romania's path has wider relevance across the region.

Quality of laws

Not all of Romania's market governance rules are high-quality, but international institutions and the experts interviewed for this research alike consider these laws well-developed. The EBRD (2007) notes the high quality of insolvency and secured transactions laws, while the ability of corporate governance rules to protect minority shareholders' rights is considered low. By 2005, the European Commission was satisfied with the Company law chapter of Romanian accession negotiations, asking only for efforts to improve financial reporting and efficient follow-up of these provisions (EC

[1] Unfortunately, the 1999 and 2002 BEEPS figures are not entirely comparable due to minor changes in the question phrasing, although the meaning of the question has not changed significantly.
[2] more firms see courts as fair and impartial, honest/uncorrupted, quick, affordable and able to enforce their decisions in 2005 than in 2002, but the overall percentages are still low: fewer than half of the Romanian firms interviewed attribute these qualities to courts. All of these figures are, however, better in Romania than in the rest of South East Europe.

2005: 37). The EBRD considers the Romanian Insolvency law one of the leading such laws in EBRD's countries of operation and highly compliant with international standards (EBRD 2006: 13). This is all the more significant because this is not one of the laws that fell under EU conditionality. In other cases, such as competition law, the role of the EU in improving legislation has been more direct, and its conditionality more important for beating back government opposition related to state aid (Young 2008).

The EBRD also measures the application of this legislation through legal indicator surveys, which ask legal practitioners how the laws would operate in their countries based on a specific scenario. In terms of speed of disclosure, enforceability and complexity of the corporate governance rules, Romania fared generally better than most Central European countries in 2005. This was also true for commercial legislation already in 2001 (EBRD 2002: 38). However, Romania fares worse than the other Central and South-East European countries in the institutional environment, which consists of judicial competence and experience, reliability of corporate books, auditor independence, the presence of international auditing firms in the country, and the extent to which patronage and corruption might influence decisions (EBRD 2005 Annex 1.2). Overall, the EBRD legal surveys suggest enforcement of commercial legislation is better than expected in some areas, though implementation problems in market governance remain.

International influences

Many scholars recognize that international actors' influence on economic reforms in transition has not been uniform, though the pull of the EU, combined with its

conditionality, as well as conditionality from international lenders (the IMF and the World Bank) have amounted at least to strong international attempts to influence policy. In contrast to black-or-white arguments about the role of these actors in economic policy in transition, new theories differentiate the effects of international influence based on the mechanism of conditionality (Grabbe 2001), the consistency of the message (Grabbe 2001, Epstein 2006), the prior policy configuration of the respective policy sector (Jacoby 2005, Epstein 2006), and the receptivity of domestic actors (Epstein 2006). None of these authors address specifically market governance issues, but we can infer some aspects of influence from their analysis of other sectors. Specifically, we would expect the influence of the EU to be highest in those areas where the consistency of the EU message is high, where the density of domestic actors is relatively low, and where there is not an established prior policy. Most areas of market governance fit this bill, though some are more specifically subject of EU concern, and therefore present a more consistent message (competition policy, company law) than others (bankruptcy, corporate governance). Thus, overall we would expect high EU influence in market governance institutions, and indeed these laws show high compliance with European requirements.

There are some reasons to believe that EU influence may not have been as strong as conditionality arguments imply. Successive Romanian governments have a spotty record at responding to conditionality, having breached most IMF agreements so far (Pop-Eleches 2006), and the policy advice of different international organizations has sometimes been inconsistent, with the EU, for instance, being more generous with guidelines for public spending than the IMF. Overall, these reasons have not impacted the field of market governance much. The more valid concern is that adopting a rule on paper

may mean surprisingly little in practice, unless the transferred rules have also been actively appropriated by local politicians and social actors (Sissenich 2008, Scherpereel 2006, Pridham 2007a). The rationalist logic of consequence, on which conditionality is based, and the constructivist logic of appropriateness, on which concepts such as socialization of elites and Europeanization are based are compatible in this case, and can reinforce each other in various ways (Sissenich 2008). However, Pridham (2005: 138) points out that Romania "has a reputation in EU circles for producing fine-sounding documents that remain on paper". Thus, the influence of vested interests on market governance laws could still appear at the implementation phase. Indeed, commercial courts themselves suffer from corruption and state capture. In 2005, just under 50% of Romanian firms interviewed for BEEPS claimed that the functioning of the judiciary is a problem for doing business (World Bank 2005), although a higher share of Romanian firms than the Eastern European average saw the judicial system as honest, uncorrupted, fair and impartial (about 35% of all firms and slightly more among firms who have recently used the system). Moreover, firms perceptions of the sale of commercial court decisions have also dropped between 1999 and 2002, similarly to capture of laws through sale of Parliamentary votes, from 17% in 1999 (significant and very significant) to just over 5% in 2002 (World Bank 1999, 2002). These statistics, supported by my interviews, suggest that most of the problems with the legal system are due to cumbersome functioning, lack of experience or expertise of judges in commercial matters and other such transitional pains, rather than due to firms' attempts to influence market governance at the implementation phase.

By comparison to the numerous difficulties in adoption of EU-required democratic governance rules due to opposition from politicians (Young 2008), the market governance domain seems to have adapted to EU requirements in a surprisingly unproblematic fashion, suggesting that there was little opposition from vested interests to the adoption of these laws. In addition, many countries outside EU conditionality or even influence, like Russia and the non-EU Balkan countries, also show much progress in some market governance reforms, such as concessions legislation, corporate governance and insolvency (EBRD 2006[2]). Thus, an explanation of the creation of market-supporting institutions in Romania that focuses only on EU pressure would be incomplete. Moreover, EU influence on the drop in perceptions of state capture is more indirect than through improvements in market governance laws; it acts instead through the impulse for FDI and privatization, as I argue later in the paper.

Structural change in response to economic crisis

Apart from geopolitical changes that opened Romania's road towards EU membership, economic and policy changes can be explained by focusing on the effect of crisis as a catalyst for reform. In 1996-9, due to the sudden price liberalizations and subsidy pullback brought on by a new government's reform impetus, Romania went through a second dip in GDP levels, a new bout of high inflation, and low international reserves. In 1999, the IMF, the World Bank and the EU signed loan agreements with Romania, helping to narrowly avoid default on sovereign debt caused by liquidity constraints (EBRD Transition Report 2000). This crisis situation, and the advice received

from International Financial Institutions (IFIs) prompted the government to follow macroeconomic stabilization with financial reform. Two issues related to this crisis argument need further attention: how financial reform was achieved in spite of vested interests happy with the status quo, and whether financial reform was really the catalyst for further changes in the economy.

Financial market development is believed by some to be the key impetus needed to avoid a low-performance equilibrium (Csaba 2007, Calderon and Liu 2003). Credit market imperfections were one of the major factors that caused the initial output collapse in all transition economies (Campos and Coricelli 2002), and clientelistic allocation of finance was a prevalent feature of the early post-communist political economy even in Central Europe (King 2001). This transition specificity survived longer in South East Europe and the Former Soviet Union due to the slower pace of reform. The restructuring of the banking system could have contributed to changing business incentives away from rent-seeking and towards market strategies. Access to credit can also make a difference in the rate of transformation of a transition economy.

Banks in transition economies had plenty of perverse incentives, which often resulted in vicious circles. These include political rationing of credit for the state-owned banks, insider lending by small new private banks to their owners, a need to hide non-performing loans by lending even more to the problem debtors, moral hazard caused by expectations created by indiscriminate bail-outs by governments, and tax and accounting loopholes allowing the hiding of insolvency. Romanian banks were not oriented to serving customers, but rather to making profits from high-interest treasury bills (issued after 1996), and, for the state-owned banks, which held the majority of banking assets

before 2000, to subsidize state-owned companies (Doltu 2002). In 1998, the Romanian Center for Economic Policies estimated that 65% of firm investments came from retained savings, and only 8% from domestic credit, lending credence to the notion that the banking system was failing to perform its function of intermediation between savings and investment (ibid.). The Romanian banking crisis of 1998-1999 (again later than in most CEECs) was more severe than in similar countries, with the share of doubtful and non-performing loans reaching 66.2% of total private loans in 1998 (Doltu 2002: 299). The non-performing assets were concentrated in four banks: Bancorex, Banca Agricola,. Bancoop and Banca Albina. All of these were subsequently either liquidated during the cleanup of the system, or sold to foreign investors. 1999 was the turning point for the Romanian banking system, when the National Bank of Romania, with a new Board of Directors, launched a restructuring programme supported by laws upgraded in 1998-9, such as the Banking Act (Law 58/1998), the National Bank of Romania Act (Law 101/1998), and the norms added to the Bank Insolvency Act (Norms 9/27 September 1999) (Doltu 2002).

Bank privatization started in 1998 with the sale of majority stakes in two banks (Romanian Development Bank and BancPost); this and the exit of eight banks from the market in 1999-2000 meant that some improvement was immediately achieved. Banking supervision and mandatory corrective action measures by the NBR were also improved with the legislative changes of 1998-9, and the Bank Asset Recovery Agency (AVAB) was established to deal with failing banks in a centralized manner. By 1999, there were also 19 majority foreign capital banks and 11 majority private Romanian capital banks, though state-owned banks in 1999 still held 62% of total assets (Doltu 2002).

The reform of the Romanian banking system was not without its problems, the last round of cleanup of bad debts costing about 4% of GDP, the highest fiscal burden in Eastern Europe. However, interest rate spreads narrowed, bad loans as a percentage of total loans and of GDP have plunged rapidly, and a credit boom, especially in retail lending (mortgage in particular) ensued, so that by 2005, Romanian domestic credit to private sector had grown to 11.3% of GDP (from 7.2% in 2000) (EBRD 2007). Stock market capitalization, another indictor of financial development, also rose spectacularly from 3.4% of GDP in 2000 to 22.3% in 2005 (ibid.). These figures are still much below Central European averages, let alone world or EU averages. In particular, the share of domestic credit to private sector in Romanian GDP (11.3%) is still only half of the average for South-East Europe of 23.9%, and only a fraction of the average for Central Europe (42.3%) or for the EU (85.8%). However, the fact that there is still much room for development in these indicators should not detract attention from the quick progress achieved after 2000. The legislation supporting the banking and non-banking financial sector has also continued to improve, so that by 2007 even Romanian securities law, a field that had lagged behind until the last couple of years, was in high compliance with best international standards. The enforcement of this law, measured by the EBRD Legal Indicator Survey 2007, also shows high transparency standards for IPOs, and effective private and public enforcement mechanisms (EBRD 2007).

Economic crisis combined with international influences (the Structural Adjustment Programme supervised by the IMF and the World Bank that Romania had to sign on to, in the wake of efforts to be considered for NATO and EU membership) have created the initial impetus for banking sector reform. This combination of factors proved

stronger than the influence of the beneficiaries of clientelistic finance. Who were these beneficiaries? Pasti (2006) argues that if until 1995 bank credit was a means of transferring subsidies to politically connected SOEs, since 1995 bank credit started to be used for the financing of private politically connected entrepreneurs at negative interest rates and without much hope of repayment, allowing them the accumulation of working capital, either for new business, for private consumption or for buying off SOEs offered for privatization, and amounting in effect to the creation of a national capitalist class. Some beneficiaries of these credits, such as George Constantin Paunescu, were able to get personal credits of more than $10 million, and open private banks with this money, so that credit could keep flowing to their private businesses (Pasti 2006). However, unlike in Russia or in Bulgaria (see Johnson 2000, Barnes 2007) banking in Romania was not deregulated during the last years of communism, so private banks had less time to consolidate their influence on the state after siphoning off state resources into the new private sector. They were not able to stop the reform of the banking system, though the two years it took the Banking Law to pass in Parliament may suggest that they tried. They were, however, able to use banking reform for a last benefit: the writing off many of their debts, through the transfer of bank debts to AVAB and the write-off by the government of many of the bankrupt banks' receivables at a high cost to the economy (estimated at between 4 and 6% of GDP). By the end of 1999, USD2.3 billion were in AVAB's portfolio, and very few of those bad loans were ever recovered, amounting to the lowest recovery rate for bad debts among reforming countries (Movit 2006). The new Romanian capitalists also managed to avoid prosecution for fraudulent behavior: for instance, the bankruptcy of Columna Bank, started in 1998, was still surrounded by

uncertainty in 2004, and Razvan Temesan, a main actor in the Bancorex case, was able to use his political connections to escape prosecution (SAR 2002[3]).

In spite of the government's success in cleaning up the banking system, it is not clear that reform in this domain was able to trigger substantial changes in the rest of the economy. While financial sector development can have a large effect on growth by reducing firms' liquidity constraints, in South-East Europe, about 40% of small firms, 60% of medium firms and 70% of large firms did not consider themselves financially constrained in 2005, using mainly internal finance for further investment (EBRD 2006). Moreover, older and larger firms, whose access to credit was better to begin with, tend to benefit more from bank loans than smaller newer firms (ibid.). Transition economies may also have specialized in industrial sectors where external finance is not vital, and the effect of the entry of foreign banks on firm growth was mitigated by the fact that these banks tend to specialize in household, not corporate finance (ibid). The SOEs that were previously dependent on clientelistic bank credit were privatized, while foreign companies had financing from parent companies. Thus, while financial sector reform has preceded industrial restructuring and other institutional reforms, and while the achievement of reform in this sector is itself part of the explanation for broader institutional reform, it is unlikely that financial sector reform tells the whole story of how laggard transition economies such as Romania have been able to reform. It is not at all clear that banking sector restructuring was the factor that eliminated state capture.

Privatization, market governance reform and institutional capture

Market governance reform and state capture

Admitting the strong influence of the EU and of the IFIs on the institutional reform process, it is still surprising that EU-friendly market governance rules were adopted in such wholesale fashion, unlike democratic deepening rules for which adoption pressure was much stronger. Some of the democratic deepening rules pushed by the EU, such as anti-corruption measures, were intensely opposed by political actors, resulting in adoption delays and watering down of the provisions of these laws or simply ineffectiveness in their implementation (e.g. the National Integrity Agency). In contrast, many of the market governance laws were designed with heavy input from foreign advisors and adopted without much debate, often as a requirement of harmonization with EU legislation. The success in the adoption of market governance rules is accompanied by a lack of evidence of opposition from business interests to these rules in the press[3]. This seems to suggest that contrary to the scholarly opinion that these rules would hurt powerful firms by eliminating their unfair early advantages, they were in fact considered simply irrelevant by the interests expected to oppose them, or at least not worth opposing. The explanation for this absence of opposition has various elements.

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[3] The absence of scandals related to market governance rules is not likely to be due to media bias against reporting on this particular type of corruption scandal, or to lack of freedom of the press. In spite of reports of political interference in the press and of attempts to introduce laws unfriendly to journalists, my press research suggests that the Romanian press is vitally engaged in unmasking corruption, judging by the attention paid to corruption scandals in general. My interviewees pointed out that certain newspapers have an undeclared bend to the political right or left depending on their ownership, but also remarked that the press is doing a good job at publicizing corruption, and pointed out to me which are the more reliable newspapers and news sites. There is no reason why the press would underreport attempts at institutional capture in market governance relative to other corruption scandals. Newspapers often report on Parliamentary debates on laws and amendments such as the budget laws, minimum wage, privatization etc. but market governance laws have received very little attention, suggesting that they were not particularly controversial.

First, there is some evidence that not all Romanian firms use legal institutions to the same extent; the use of the legal system in transactional governance depends instead on transition-specific firm characteristics, such as whether the firm is a new private company, a privatized one or a state-owned company (Murell 2003). Also, banks adapted differently to the new banking legislation; foreign banks increased lending more than their local counterparts as a result of legal changes regarding collateral and creditor's rights (Haselmann, Pistor and Vig 2005). This suggests that the new sophisticated market governance framework may have mattered to foreign investors more than to local firms, who were used to functioning in a less defined legal environment. Indeed, the lacunae of market governance were often cited as a reason why foreign direct investment (FDI) failed to flow into transition economies, so the creation of this legal framework at the advice of foreign consultants may simply have contributed to the growing confidence of FDI, without significantly affecting local firms, and thus without prompting such firms to oppose legal change.

Secondly, avoiding rules at the implementation phase may have been the preferred strategy of local firms. Minority shareholders' rights are a case in point. One of my interviewees told me the story of her attempt to monitor the company in which she had obtained shares through mass privatization. When the AGM of the company was cancelled for lack of quorum, she went to the company's headquarters and asked to see the books in conformity to Company law (Law 31), which she knew well. The company did not deny her right to see the books, but asked for an exorbitant sum to photocopy the financial statements, thereby effectively denying her access. Legal indicator surveys

show, however, that some areas of enforcement of market legislation have improved in Romania.

Business interests may also have relied on enforcement problems rather than on opposing legislation because they did not have the organization level and the systematic ties to politicians to influence laws at the basic adoption level. Romanian business associations are relatively weak in their ability to influence legislation, and often complain about their opinion not being taken into consideration when laws are changed. Interviewees pointed out that Western-style lobbying is starting to appear in Romania, but it is not commonplace yet. Even when it comes to illegal state capture, Romanian firms do not have the kind of stable ties to political parties as Bulgarian business groups appeared to (Barnes 2007, Ganev 2007). Examples are Paunescu, who was initially a supporter of the communist-successor party in power but seemed to change allegiances in 1996 (Gallagher 2005), and Dinu Patriciu, whose main privatization deal was obtained during the social-democratic party tenure, in spite of his known liberal orientation. Some business people attempting to influence law-making have gone into politics themselves (the most notorious is billionaire Dan Voiculescu, and recently real estate mogul Gigi Becali), only to find out that building electoral support and party organizations are not easy tasks. Thus, Romanian powerful firms may have generally preferred to act at the level where they could exert the most influence, namely the level of particularistic benefits. Romanian newspapers are indeed filled with scandals of firms illicitly obtaining exceptions from bankruptcy laws or from taxation, or benefiting from arranged auctions for public procurement contracts.

Finally, the lack of opposition to market governance rules is also due to a change in the identity of the most powerful economic actors. Initially, the actors believed to engage in state capture and to oppose institutional reforms were the communist-era managers of state-owned enterprises (SOEs), or what Pasti (1997, 2006) calls 'the industrial technocracy'. These managers created private 'tick' firms (*firme-capuşă*) that did business with the SOEs, in effect transferring valuable resources from these large enterprises into private hands by buying up raw materials from the SOEs at very low prices, and selling intermediary goods back to them at inflated prices. The conversion of state property into private property through such satellite firms has been called by Stark and Bruszt (1998) 'recombinant property' in the context of network sociology, and is not unique to Romania. This conversion has involved the state's tacit cooperation; the siphoning off of SOE resources was made possible by the state's acceptance of growing tax arrears of the large SOEs, as well as arrears towards utility companies. We can think of this process as an early attempt at state capture, if we use a broad definition that involves informal relations between politicians and SOE managers (but not necessarily illicit payments[4]), electoral influence of SOEs due to their large number of employees, and the use of state resources (money and property) for private gain, rather than the capture of institutional rules. However, these processes amount more to the gathering of an initial unfair advantage by SOE managers than to subsequent state capture defined in institutional terms. Most of these managers were actually unable to transform these short-term benefits into long-term advantages, due to political changes (these managers were closely connected to the communist-successor party who lost the 1996 elections), to

[4] BEEPS distinguishes between state capture and influence, and the surveys confirm that some large firms, especially large employers, have influence over decisions that affect them without the need for illicit payments, due to their structural importance in the economy.

privatizations, and to the fact that lack of market experience and sufficient capital prevented these small tick firms from becoming true economic powerhouses with political influence. Starting in 1997, with the change in government, the privatization agency initiated bankruptcy procedures against SOEs, and was no longer allowed to channel subsidies to enterprises (Pop 2006), suggesting that the privileges of the industrial technocracy had come to an end.

Rather than large incumbent firms, the BEEPS suggests that the state captors were new market entrants, including local entrepreneurs with foreign partners. The reasoning for their need for state capture offered by the designers of the BEEPS is that in order to compete with the incumbents, these new entrepreneurs had to engage in state capture to secure their property rights from predatory state officials and to secure competitive advantages into the emerging institutional framework (Hellman and Kaufmann 2001). In the Russian context, it has been noted that many of the oligarchs are relatively young and have transformed the businesses they often fraudulously acquired into Western-style corporations functioning according to market rules. The same can be said about the new Romanian economic elite, who usually runs large private business according to Western market rules. Most of the time, these new business people have not made their fortunes in industrial production, though industrial acquisitions through fire-sale privatizations are now part of their portfolios. Instead, a look at the wealthiest Romanians reveals that they have most assets in media, real estate, finance, oil, international trade, tourism and sports (Capital 2007). Gigi Becali, the controversial owner of soccer club Steaua and president of the xenophobic New Generation Party, is an extreme example: he made most of his $3 billion wealth in real estate speculation, buying up large parcels of land at the outskirts of

Bucharest, in areas where future industrial or real estate development was expected. The entry of many millionaires into the real estate business has coincided with the explosion of prices in this field: average apartment prices in Bucharest have soared five times in the last 4 years (Capital 2008). In contrast to Becali, Dinu Patriciu, an ex-politician for the National Liberal Party, has built his $3.3 billion by buying oil refining capacity from the Nastase government in 2000 with the help of an American partner, a big price discount from the government, and some financial wizardry, including the heavy discounting of debts of former SOE Petromedia and financial deals for political allies. He bought Petromedia for $50 million after it had almost been sold by the previous government to a Turkish company, then convinced the government to forget $600 million in debt, expanded his company into an international oil empire enviable by any Western business standards, and eventually sold it for $2.16 billion to the Kazakh state oil company, becoming the richest Romanian (Hotnews.ro 2007, Miclescu 2005). Yet other types of billionaires have made their fortune in the financial sector (Sorin Ovidiu Vantu, for instance is tied to the National Investment Fund, which collapsed in 2000, defrauding thousands of small investors), or in international trade thanks to access to this sector before the fall of communism, access reserved for members of the intelligence services (Dan Voiculescu is the best example of this).

This new elite often took advantage of lax or poorly enforced rules (e.g. financial regulations in the case of Vantu) or of non-transparent privatizations, and proved adept in making political connections, which they often maintained through their influence over the media. The new entrepreneurs were nonetheless much more pro-European and likely to accept the idea of conducting business under the rules set for Western corporations.

They were thus less likely to oppose the creation of a Western market governance framework. This does not mean a commitment to playing by the rules, but it shows a higher degree of market sophistication of the new elite compared to the managers of SOEs. As pointed out to me in an interview by a foreign businessperson, these Romanian entrepreneurs have now often become professional business people, and their learning process in business management was aided by the money they managed to siphon off from the state, which allowed them to make more costly mistakes in business. In addition, these business people often grew their fortunes with the help of foreign partners or managers that provided the much-needed business know-how.

The importance of political connections for initial wealth accumulation notwithstanding, business people could not always count on these connections, suggesting a weakness of state capture strategies. The case of Patriciu is instructive in this respect. Patriciu was a prominent liberal MP in the early 1990s, before he dropped out of politics to become a businessperson. His allegiance to the Liberal party came under question (though he never switched sides politically) when he obtained the Petromedia privatization during the social democratic government of Nastase. Patriciu was later harassed by the social-democrats for this suspicious privatization and sent before the anti-corruption prosecutors (Avram 2004), but paradoxically he became even more controversial after 2005, when the Liberal party was in power. In 2006 he found himself used in the political fight between President Basescu and Prime-Minister Tariceanu, accused of guiding liberal party policy from the shadows (Nicut et al 2007). The accusation of state capture against Patriciu and Tariceanu brought the issue of business-politics ties starkly in the center of public attention, though several of my interviewees

pointed out the Patriciu case as an example of political uses of corruption and state capture accusations. Around this time, Patriciu also started having legal troubles related to shady financial deals (BBC Romanian 2006), and eventually had to sell his Rompetrol oil empire. Thus, having political ties is not always safe for business people, due to the uncertainty of political support and to the quick shifting of political alliances.

Having explained why market governance reform did not encounter much opposition from vested interests, the questions remaining are why perceptions of state capture have dropped, and whether these perceptions are accurate.

Privatization and state capture

In spite of MEBO (Management-Employees Buyouts) and of two rounds of voucher privatization, large-scale privatization did not take off in Romania before 1997, and proceeded at a very slow pace until 2000 (EBRD 2000), so that by 2001, only 8 large companies had received foreign investment of more than $200 million[5]. With few exceptions (Dacia Pitesti and Daewoo), most of these investments happened after 1999, the year when the first BEEPS survey found high state capture in Romania. Moreover, one of the main privatizations that happened before this date, that of Romtelecom, was shrouded in scandal, with high-level government officials questioned over alleged illegalities. While the pace of privatization increased in 1998 under the Vasile government, Radu Sarbu, the new head of the State Property fund, was often accused of cutting corners in terms of transparency of privatization (Gallagher 2005). Most of the privatizations of 1997-2000 focused on sales to local, rather than foreign, investors, at

[5] These were MD Frati (to Frati), Romanian Development Bank (to Societe Generale), Petrotel (to Lukoil), Sidex (to Ispat), Romcim (to Lafarge), Dacia (to Renault), Romtelecom (to OTE), and Daewoo Auto (to Daewoo) (SAR 2001).

heavily discounted prices, amounting to a short-lived 'golden age' of local capital (Pasti 2006).

More generally, the time in office of the Democratic Convention (CDR) and president Constantinescu (1996-2000) was marred with corruption scandals, such as the collapse of the largest investment fund, FNI, which held 75% of the mutual fund sector assets, MP Catarama's alleged fraud in the SAFI investment fund, and a shady government contract with Bell Helicopters that resulted in the firing of the finance minister. These scandals were especially over closeness of the government to business interests, and over the lack of control over intelligence services, whose representatives made huge fortunes. Even the President, who had started a publicized anti-corruption campaign, came under suspicion in a cigarette smuggling scandal, which dealt a death blow to his previously high popularity (Gallagher 2005). None of these scandals could specifically be identified as institutional capture, however, defined as the attempt of business people to change laws in their favor through bribes to politicians in power. Nonetheless, due to the surfacing of these scandals on the clock of a political coalition that campaigned specifically on integrity and dignity, and perhaps due to the feeling that the state could not control intelligence forces or the shady credits and privatization deals involving new entrepreneurs, this situation was perceived as state capture by business people who answered the BEEP survey in 1999. There is, however, virtually no evidence that the high-level corruption abundant in Romania at that time was aimed at keeping these institutions weak, in other words, at capturing them.

The rapid change in perception of state capture between 1999 and 2002 can be attributed in particular to a major policy change starting in 2000: a proactive and much

more open attitude of Romanian governments towards privatization to foreign investors. This started with the Isarescu government, but continued after the elections with the Nastase government, in spite of the leftist orientation of this government. The main policy change of the Nastase government (2000-2004), was giving a serious push to large-scale privatization, and in particular to selling state assets to foreign investors. Pasti (2006) considers this commitment to privatize to Western European companies a political deal necessary for Romania's accession to the EU. Romania's attractiveness to foreign investment also increased considerably with the news of the opening of accession negotiations.

The beginnings of this process of privatization through direct sale to foreign owners were not smooth, with several privatization deals being overturned and labour unrest (e.g. at steel-makers Resita and Sidex) making the property rights of foreign investor less than secure. However, these problems were more prevalent before 2000, when several privatizations to foreign investors were reversed and the assets then sold to Romanian investors instead. The sale of Sidex, the producer of three quarters of Romanian steel, (or 15% of gross industrial output and 5% of Romanian GDP) to Mittal Steel in 2001 was an important turning point in the privatization process. This privatization, together with that of several other large companies (such as Alro Slatina, Rafo Onesti, the Constanta Naval Yard), eliminated a large portion of deadweight losses from the economy, and provided growth-sustaining investment. The energy sector followed in the privatization wave, with the gas and electricity distributors, and well as the oil sector giant Petrom, the largest Romanian industrial company, which was sold in 2004 to Austrian OMV for 669 million euros and another 856 million in pledged

investment. These privatizations did much to assuage initial fears that the energy sector was going to replace the banking sector in contributing soft credits to loss-making enterprises thorough utility bill arrears. The government seemed committed to further privatization, and backed its statements by some reformist actions such as the liberalization of energy prices, reducing the number of budgetary funds from 18 to 9 in 2001, passing the budget law on time for the first time in 2002, and appearing ready to cut off power to companies not paying their utility bills (OECD 2002). The resumption of growth in 2000, the slowing down of inflation in spite of higher energy prices, and Romania's growing chances to join the EU culminated in Standard and Poor improving Romania's risk rating in 2001, which provided further investor confidence. The magnitude of the wave of foreign investment post-2000 is evidenced by the fact that 85% of the total capital sold to foreign investors in the Romanian transition was concentrated in the 2001-2004 period, representing almost 6 times the amount sold in 1997-2000 (Pasti 2006).

My interviews with business people and local analysts in Romania also point out that the impact of privatization to foreign investors on diminishing perceptions of state capture was substantial. Some pointed out that the end of privatization means fewer opportunities for state capture, and that now that the Romanian economic elite has acquired substantial wealth, it is less willing to fight for more. Others suggested that corruption has become more limited and more sophisticated (less visible) with the conclusion of privatization. It was also suggested to me that corruption happens mostly among Romanians, and that foreign management of enterprises has changed internal functioning rules of the privatized firms. Foreign companies may have paid bribes in the

initial phase, in order to gain market access, but their subsequent influence on Romanian politics, especially for firms from large EU countries, was closer to the Western lobbying model. The Foreign Investors' Council lobbying for better competition and other market governance laws (Pasti 2006) is a good example in this respect. Thus, to the extent that state capture existed, it referred not to the capture of basic institutions of market governance, but to the capture of state resources through short-term strategies such as forged privatization auctions, exceptions from tax payments or other regulations, non-payment of debts etc. These strategies imply influence over laws in a much more limited way than the design of biased market governance institutions. Some of these strategies persist, as evidenced by the numerous corruption scandals in the press. However, with the conclusion of most important privatizations, the most important illegitimate way of capturing state resources has disappeared, bringing Romanian business people's use of corruption much closer to European practices. In the words of one of my interviewees, corruption has now become merely a transaction cost of doing business.

Conclusion

Romanian high-level corruption involving powerful business people does not amount to institutional capture. Firms get individual, particularistic benefits, within the context of relatively developed market rules. Thus, in spite of many scandals of unfair advantages to firms in the press, there is no evidence of firms trying to influence the basic rules of market economy. Firms often take advantage of the bad functioning of the legal system and of the lack of state capacity, but their strength relative to the state, and thus

their hold on the state, is temporary, uncertain, and limited to one-time benefits, because they do not control broad rules of market governance.

During Nastase's 2000-2004 term, and increasingly afterwards as well, many Romanian commentators pointed to a Latin American type of transition marked by growing social disparities and predatory elites (SAR 2002, Flonta 2003). There are still numerous scandals in the press that seem to confirm this view. Attempts of political parties to avoid legal checks on their indiscriminate power may amount to institutional capture by politicians of state monitoring and oversight institutions. However, this is different than institutional capture of market governance rules by powerful business people. In spite of the continuing high-level corruption scandals, due to the changes in the economy, and in particular to the near-completion of large-scale privatization, the perception of businesspeople about state capture improved considerably. Romanian business people, as well as the academics, think tank experts, and journalists and businesspeople I interviewed now make a distinction between "regular" corruption aimed at specific benefits from the state, a type of corruption that exists even in Western economies (e.g. bribes for public contracts), and a more essential type of corruption, which has the most potentially pernicious effects on the economy, because it refers to institutionalizing unfair advantages, making the rules of the market themselves, rather than bending them when an opportunity arises. Such institutional capture was attributed in 1999 by survey respondents to the privatization process, highlighting the illegitimate ways in which capitalism was built in transition, and specifically the illicit ways in which property was initially acquired. Nonetheless, these property advantages were not later sustained through institutional capture of basic laws.

Building market infrastructure in Romania was not the hard part of reforming transition economies. Delays in the building of this institutional infrastructure were certainly taken advantage of by firms early in transition, but once legal capacity was improved and external influences, including those of FDI, go stronger, the creation of these market rules was relatively unopposed. This becomes evident especially if we contrast them with the much more contentious democratic governance rules.

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