# Romania's Membership of International Financial Institutions – a Necessary Change

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*Abstract*

*After a 17-year transformation process from a centralized economy to a functional market economy, Romania joined the European Union on January 1, 2007. Today, 11 years after the EU accession, Romania is still looking forward to achieve many of the real convergence conditions and also to join the euro zone. Independent of these, as an upper medium income country is now the time to evaluate its role, benefits and obligations as a shareholder in various international financial institutions – multilateral development banks and multilateral regional banks – as a first step in assuming an active and positive role in the development international community.[i] At the EU level, international development is slowly but constant evolving to a coherent and common approach. However, individual member states still have a lot of space to maneuver to use specific individual approaches in pursuing their own interests.*

*The objective of this paper is to signal that for Romania the right time has come to change its passive and reactive approach of its membership in various international financial institutions for a new dynamic and active approach. In terms of financial resources that can be mobilized and used for international development Romania cannot realistically aspire to stay along with the big traditional donors. However, its relatively small contribution can be leveraged by its membership in such multilateral and/or regional institutions so to maximize the benefits both for the international community and for the Romanian taxpayer.*

*Keywords:* Development, International Financial Institutions (IFI), Multilateral Development Banks (MDB), Multilateral Regional Banks.

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## Background: International Financial Institutions (IFIs) as a development community[ii]

An IFI is a financial institution established by several countries and which is subject of international law. The national governments (or the central banks as is the case for the Bank for International Settlements) are the owners and shareholders. Most of today's IFIs were established in the last 50 years with the main objective to improve international cooperation in managing the global financial system and, in some cases, to help the reconstruction of large geographical areas affected by years of wars or helping countries to transform their economic system after major political changes. For instance, the International Bank for Reconstruction and Development's initial role immediately after the end of World War II was to help reconstruction of Western Europe. Also, the European Bank for Reconstruction and Development main role during the 1990 was to help the development of the private sector in countries from the former socialist Eastern European block.

A more in depth classification of IFIs would distinguish between: a) Multilateral development banks (the most common are Bretton Woods institutions – The World Bank Group and the International Monetary Fund; b) Regional development banks; c) Development agencies, and d) Regional financial institutions.

Differences among various types IFIs comes from several specific characteristics such as separation among members as "part one members" or donors and "part two members" or borrowers, all members are borrowers (the advantage being that the IFI can attract funds from the international markets at lower costs than any of its individual member country), open or limited membership and type of projects that can be financed, technical assistance can be provided or not, advisory services and knowledge that can be transferred, and, of course, types of financial products developed and used (concessional financing instruments, credits, guarantees, grants, etc.), the size of the balance sheet, scope and area of operation.

**Table 1: The relevant IFIs for Romania (including Romania year of membership)**

| Multilateral Development Banks (MDB) | | |
|---|---|---|
| | Established | Membership |
| The World Bank (IBRD and IDA) | 1944/1960 | 1972/2014 |
| European Investment Bank (EIB) | 1958 | 2007 |
| European Bank for Reconstruction and Development (EBRD) | 1991 | 1991 |

| | | |
|---|---|---|
| **Multilateral Development Banks (MDB)** | | |
| Council of Europe Development Bank | 1956 | 1996 |
| Asian Infrastructure Investment Bank (AIIB) | 2014 | in progress* |
| **Regional MBDs** | | |
| Black Sea Trade and Development Bank | 1997 | 1997 |
| Council of Europe Development Bank | 1956 | 1996 |
| **Multilateral Financial Institutions** | | |
| European Commission | 1951 | 2007 |
| International Investment Bank | 1970 | 1970 |
| International Bank for Economic Cooperation | 1963 | 1963 |

* Romania officially expressed its interest and intention for membership; The Ministry of Finance initiated in 2017 the domestic legal procedures for membership.

**Romania's participations in International Financial Institutions (IFIs)[iii]**

Romania's participation in international financial institutions is reflected by its contribution to the capital of those institutions. With just about 1.75 of its GDP (about EUR 2.6 billion) Romania as shareholder is not significant and not too different from other countries in its region (Bulgaria, Poland, Ukraine, etc.) However, the relative position among other shareholders is reflected, in many cases, not just by the amount of capital subscribed (paid in or callable), but it is determined by a combination of many elements which may include (for instance in the IBRD case) the country's share in the global trade, the economic growth in a certain period, etc. A complex and dynamic formula and not just the simple share in capital may allow a more realistic distribution of influencing power among members/shareholders.

Sometimes, countries presence/representation in top management or in the boards of IFIs could assure more voice and more influencing power even if these are not necessary reflected by particular countries' share in capital. Poland, for instance is not a major shareholder in the IMF. However, it has a position of Executive Director in a constituency also including Switzerland – a "rich" shareholder and a donor not a borrower. In the "cousin" institution – IBRD -- Austria held for a spell the position of Executive Director of a constituency also including Belgium, in spite of the fact that it is just a minor shareholder compared with Belgium (Austria contribution to the capital is just 0.65 compared with 1.67 for Belgium). The Netherlands, although the biggest shareholder in a large constituency including Belgium and Israel (to mention just the strongest shareholders), finds their best interest achievable at the price of a 4 years rotation with Belgium for the position of Executive Director in the IMF executive board.

**Table 2: Romania's participation in some major IFIs (EUR Million)**

| IFI | Subscribed capital (paid and callable) |
|---|---|
| European Investment Bank | 1,270,021,000.00 |
| World Bank Group* | 714,519,589.57 |
| European Bank for Reconstruction and Development | 144,070,000.00 |
| Black Sea Trade and Development Bank | 322,000,000.00 |
| Council of Europe Development Bank | 59,914,000.00 |
| International Investment Bank | 76,690,900.00 |
| International Bank for Economic Cooperation | 25,500,000.00 |
| Total | 2,612,715,489.57 |

* Includes International Bank for Reconstruction and Development (the World Bank), International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA) and International Development Association (IDA)

*Source*: Ministry of Public Finance, Romania

Refining the gross figures on subscribed capital to major IFIs makes possible to understand the long term options for a country in geopolitical terms. Where a country wants to be and, with whom around, may reflect its direct economic interests or expectations.

Before EU accession, Romania relied mostly on financing its deficits from Bretton Woods IFIs and less on European dominated IFIs. This situation significantly changed after the EU membership (2007), and is explained by two main reasons. Firstly, membership to the EU brought recognition of the successful economic transformation the country was engaged. Private capital inflows significantly increased and, improved general economic conditions allowed accessing the capital market in better terms than before. Secondly, the structure of Romania's participation in IFIs -- the first condition for potential borrowings from IFIs – also changed in a major way. EU membership implicitly brought the membership to the EIB and the European Commission. This means a sudden increased access to the EU financial resources (huge non-reimbursable funds from the European Commission and also credits from the EIB).

**Table 3: Romania's participation in some major IFIs before and after EU membership**

| IFI | % of total participations to IFIs | | |
|---|---|---|---|
| | **Before EU membership** | **After EU membership** | **Change** |
| European IFIs | 39 | 69 | □□ increase importance |
| WBG | 53 | 27 | □□ decrease importance |
| IIB | 6 | 3 | □□ decrease importance |
| IBEC | 2 | 1 | □□ decrease importance |
| | 100 | 100 | |

For Romania, EU membership meant a major shift of its participation to IFIs. Suddenly, its participation to the Bretton Woods IFIs decreased from 53 percent as share in its total participation to IFIs to just 27 percent. Participations to European dominated IFIs increased from 39 percent to almost 70 percent. (This simple explanation deliberately considers only Romania's membership to EIB and does not refer to its access to the European Commission's structural and cohesion funds). At the same time, Romania's participations to other two multilateral financial institutions observed for this study (International Investment Bank and International Bank for Economic Cooperation, both based in Moscow, Russian Federation) almost completely lost their relevance.

## Reasons of membership and accessing IFIs financial resources

Before 1990

The reasons for membership in various IFIs are of course different in certain circumstances and often reflect political options of countries that chose to adhere or not to such organizations. Before 1990, as a communist country, Romania stayed along with the other communist countries in IIB and IBEC. Its option for membership to the Bretton Woods institutions was not explained by any understanding of a common set of values and responsibilities towards the international community. Neither was it explained by its need to access international financial markets – to attract financial resources necessary for its own development - although some borrowings were made during the 1970s and early 1980s. The main motivation was more of pure political nature – need for external recognition of its way to try to look different from other USSR's satellites[iv].

1990-2007

After 1990, Romania's motivation for membership in various IFIs has changed. The political background and aspirations were now different. The economic motivations got new substance. Romania joined the new created EBRD and soon became one of its main recipients of funds for developing the private sector. Then, in 1996, Romania joined the Council of Europe Development Bank signaling its clear (political) option for EU accession.

The substance of relationship with the Bretton Woods institutions also completely changed. The IMF and the World Bank got a leading role both in providing financing for the temporary imbalances within the balance of payments (IMF) and in directly or indirectly (through structural loans) budget support (World Bank). The borrowings from these two IFIs significantly increased to cover the external financial needs in a large extent. However, even more important than borrowing itself was the knowledge transfer needed for designing and implementing the necessary reforms. The dominant political view in Romania was in favor of a gradual approach of the transformation process. In fact, this view has materialized in a Stop-and-Go implementation of the reforms. The speed of adopting and implementing necessary changes was reduced whenever the need for external financing diminished. The speed of reforms increased when the country couldn't access the international financial markets, and the authorities were forced to ask support (money, technical assistance and advisory services) and to accept conditional finance. (Croitoru, Doltu, Tarhoaca) The Stop-and-Go approach largely explains Romania's lagging behind compared with other peer countries (former communist countries, like Poland, Czech Republic, Hungary) in the transformation process during the 1990s. (Doltu and Duhaneanu, 2011) As this cat and mouse (or carrot and stick) game was a permanent characteristic of the relationship with the IFIs in the last 25 years, a status quo and false expectations were created which now seem hard to change.

After 2007

Romania moved to a new phase. From financing the transformation process when no access to international capital markets was possible in reasonable terms to EU membership and access to capital markets. Suddenly, the relevance of the Bretton Woods institutions decreased and their role as financing and advisor was supposed to be taken by the EU. This happened just partially. Indeed, more and more money was available – mainly the non-reimbursable structural and development funds from the European Commission – and potentially more resources from the EIB.

The relevance of the IFIs as financing source for the government rapidly and significantly decreased after EU accession. Except the unusually big Agreement with the IMF in 2009 (SDR 11.4 billion) used more as a precaution to the negative effects of the economic and financial crisis, and EUR 1 billion borrowed from the World Bank in 2013, no other significant resources from IFIs were accessed by Romania. Conditional financing is obviously not suitable anymore, and IFIs are not simple ATMs that can be used whenever member countries would need "cheap cash".

At the beginning of 2018, the active government borrowings from IFIs amounted to about EUR 5 billion, while the total undisbursed amounts were just about EUR 1.7. This is significantly less than Romania's total participations to the IFIs' subscribed capital, and is another signal that the authorities should start reviewing the country's role as members in various IFIs.

**Fig. 1: Active government borrowings from IFIs in January 2018 (EUR 5,054 mill.)**

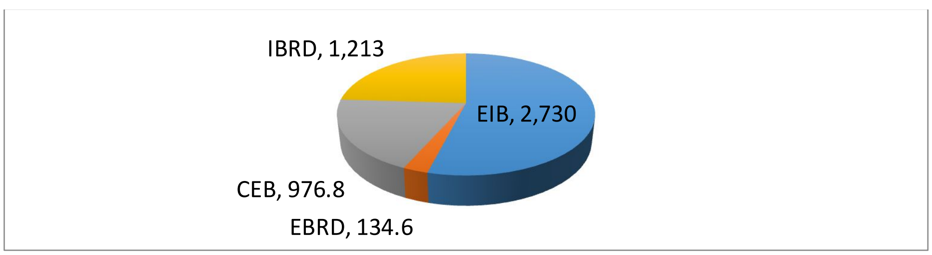


**Table 4: Active government borrowings from IFIs in January 2018**

**EUR mill**

| IFI | Disbursed | Disbursed (% of contracted) |
|---|---|---|
| EIB | 1,990 | 73% |
| EBRD | 134.6 | 100% |
| CEB | 678.6 | 69% |
| IBRD | 491.3 | 41% |
| Total | 3,294.5 | 65% |

*Source*: Ministry of Public Finance, Romania

**Time for a new approach**

The IFIs role and relevance for the upper medium income countries are more and strong questioned by the shareholders. Poor borrower countries, or part two countries, that depend heavily on resources that could be made available for them, would like to see this happening. Of course, this would be possible on the expense of MICs. These would have to accept smaller allocations of resources. At the same time, the most donors (part one countries) are more and more under scrutiny from their Parliaments, which are interested in how their own public resources are used for the benefit of the international community.

The management and the staff of the IFIs which is a major stakeholder is not necessary motivated to see a change of the existing status quo. The same, their counterparts in the borrower countries' various government structures, would hardly be interested in a change. "Old habits" generate behavioral and mental patterns and then usually become norms. The role of the civil servants (or international civil servants) is not to question norms, but to act based on them.

Politicians quickly learn how to use the IFIs, especially when conditional financing forces them to implement painful changes in the short run. Often, they blame the IFIs for imposing hardship on people instead of explaining to their constituencies why those changes are necessary. In some instances, domestic politicians try to use the IFIs for getting credibility domestically or abroad. Sometimes, a country's interest may be to borrow cheap money when capital markets are not accessible. In other instances, countries may consider capital markets too expensive. Or the private investors may consider a country too risky to invest (financial) and ask large premiums to cover the associated risk.

More than money, some IFIs provide technical assistance or advisory services (which markets does not provide). However, other IFIs often view this bundling as unfair competition and conflicts arise and are perpetuated among various IFIs. IFIs often compete to sell their money to countries, which confronts with severe budget constraints and tiny fiscal space. When a certain program or amount of money is promoted in a country by an IFI, other IFIs also operating in that country might find difficult to promote other own projects and/or lend equivalent amounts due to the limited available fiscal space for the respective country. It is true that cooperation and correlation between IFIs or among IFIs and other donors is easy to talk about but harder to realize.

In some cases, when a country has a bad track record and not a good reputation, and when the government lacks international credibility, an agreement with some IFIs might be considered desirable and useful. However, the reverse of this argument is obvious: if a country finds itself in the position to accept conditional financing from an IFI, the markets would interpret this as a sign of weakness, and would associate a higher risk to such a country.

What about the situation in which the country has a good access to the international financial market, enjoys a good rating (is not in trouble and has good perspectives), but the government finds it attractive to continue to borrow from IFIs looking to "diversify" its financing sources. The cost would be just in terms of getting the label of "opportunistic" country. This would be a good argument as long as the borrowings would exceed the volume of resources mobilized to subscribe to the IFI's capital. This argument reflects a very narrow perspective. In a wider perspective, the role of the IFIs is not to be an ATM for economically distress shareholders. International community has many common characteristics with an ordinary family. If each family member work hard and is doing their best to achieve its objectives and finally succeed, the family is better off and prosperous. If temporarily, one or some of the members gets in trouble, the others would have enough resources not just for their own immediate benefit, but also for helping their fellows. Free riders are everywhere, but they are not welcome on a long journey.

## Conclusions

Romania is an upper medium income country, member of the EU, with an excellent access to the international capital market. It could use and benefit from the membership in different ways than in the past. Romania should start viewing the membership in various IFIs from a responsible shareholder perspective, instead from a borrower position. This would take time and needs preparation, dialogue at home and with international partners.

There is a clear pattern (since 2007 and excepting the exceptional Agreement with the IMF in 2009) for the government programs financed from IFIs (other than European Commission). Romania's demand for MDBs' resources (especially, but not only, conditional finance) rapidly decreased in the last 10 years. At the end of 2017, the active government borrowings from MDBs were significantly lower than the subscription to their capital. This is not necessary the result of too many borrowings in the past that must be first repaid before accessing new resources (as in any cooperative, members can access the common resources not without limits, but based on pre-agreed quotas). It is more a result of the development of the country and of the change of the substance of Romania's demand for external financial resources.

More attention could be paid for identifying a domestic agenda in which the country must have the ownership, a proactive attitude and not just a reactive one in relationship with the IFIs. This would imply a certain institutional effort for better communication and coordination between various entities of the government (ministries and agencies).

A more proactive attitude and effective engagement as shareholder assume a better understanding of the nature, mission, objectives, capacities and limits of various IFIs. For instance, setting realistic objectives and expectations for a new domestic agenda vis-à-vis of the IFIs is an important step in building a necessary strategy as minor shareholder. Even as minor shareholder, but not necessary to remain a part two country, membership may be used for increasing the leverage of relatively small resources available for promoting its own interests in the international context. Poland, Czech Republic and Estonia may be three relatively new interesting cases to be analyzed.

Last, but not least, an evaluation of the benefits and costs of staying in certain constituencies and not in different ones might be useful in identifying a new approach of the relationship with various IFIs.

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[i] In 2017, Romania's Government decided to take a first step towards a more coherent and dynamic activity in international development by establishing RoAid – Romanian International Development Cooperation Agency. This, along with joining (as member) the International Development Agency (IDA) in 2014 are encouraging and necessary signs that sooner rather than later Romania will take on a positive and active role along with new responsibilities in the international development community.

[ii] A detailed description of the international development community is beyond the scope and objective of this paper. Instead, just the most important IFIs for Romania's economic, financial and political position will be mentioned. The paper is focused on the IFIs involved in development.

[iii] There are many misconceptions about the IFIs. For instance, they are considered extremely rich, even with unlimited resources. But the IFI's are not as "rich" as many may consider. For instance, the "richest" IFI today is the European Investment Bank with a balance sheet of about EUR 573.2 billion (EIB, 2016). The second "rich" IFI is the World Bank Group through two if its components, IBRD and IDA (assets: USD 405.9 billion IBRD and USD 197 billion IDA) (The World Bank, 2017). By comparison, almost all of the first 50 largest commercial banks have more assets than the "most richest" IFIs. Each of the first 20 commercial banks have more than double volume of assets and the first ten commercial banks have assets somewhere between USD 2-3.4 trillion (Standard & Poor, 2017). The power of IFIs resides not necessary from their assets on the balance sheet, but from knowledge and their credibility associated to certain standards they often create and impose.

[iv] Although Romania joined both the IMF and the IBRD in 1972, up to early 1990 it was not an active member both in terms of borrower and involvement in governance as shareholder. For instance, the last loan agreement with the IMF, signed in 1981, ended with Romania's early repayment and refusal to disclose to the Fund data on its economic situation. Also, no significant programs were agreed with the World Bank (one notable exception – USD 50 million loan for a new polyester plant).