OECD ECONOMIC SURVEYS

1998

SPECIAL FEATURES
Macroeconomic Stabilisation and Restructuring
Social Policy

ROMANIA

CENTRE FOR CO-OPERATION WITH NON-MEMBERS

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CENTRE FOR CO-OPERATION WITH NON-MEMBERS (CCNM)

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ROMANIA

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Table of contents

Boxes

Tables

Annexes

Statistical annex

Figures

Text

Annexes

BASIC STATISTICS OF ROMANIA
(1996 unless noted)

THE LAND

Area (sq. km)	238 391
Agricultural land (in per cent of total area)	62

THE PEOPLE

Population (thousands, mid-year)	22 608	Employment (thousands)	9 379
Life expectancy at birth: male	65.7	Employment by sector (percentage of total)	
female	73.4	Agriculture	35
Infant mortality (per thousand live-births, 1997)	22.6	Industry (including construction)	34
		Services	31

Registered unemployment (percentage of the labour force, October 1997)	7.6
Labour force survey unemployment (percentage of the labour force, Q2 1997)	5.5
Recipients of pensions (excluding disability, thousands)	4 900

PARLIAMENT (November 1996 elections)

Two chambers:	Chamber of deputies (343)	Senate (143)
Government coalition		
Democratic Convention of Romania (CDR)	122	51
Social Democratic Union (USD)	53	23
Democratic Social Party of Romania (PDSR)	91	41
Hungarian Democratic Alliance of Romania	25	11
Party of Great Romania	19	8
Romanian National Unity Party	18	7
Seats reserved for the minorities	15	

PRODUCTION

GDP (billion lei, current prices)	109 515
GDP per capita (US$, purchasing power parity exchange rate)	4 591
Gross fixed capital formation (percentage of GDP)	23.3

PUBLIC FINANCE

General government budget balance (percentage of GDP)	–4.0
General government revenues (percentage of GDP)	29.7
General government expenditures (percentage of GDP)	33.6
Public debt (end-year, percentage of GDP)	23.6

FOREIGN TRADE AND FINANCE

Exports of goods and services (percentage of GDP)	27.4
Imports of goods and services (percentage of GDP)	33.0
Foreign exchange reserves (mn US$, September 1997)	3 509.4
Gross external debt (mn US$, mid-1997)	9 743.0

CURRENCY

Monetary unit: Leu	
Currency units per US$ average of daily figures:	
Year 1996	3 082.6
End-December 1997	8 015

The draft document on which this Survey is based was prepared under the supervision of Silvana Malle and principal authorship of Joaquim Oliveira Martins and Maitland MacFarlan. Chapter IV was prepared by Anders Reutersward (OECD/DEELSA), and contributions were also received from OECD/DAFFE and OECD/SIGMA. Consultancy support was provided by Daniel Daianu and Alina Jantea. Technical assistance was provided by Anne Legendre and secretarial assistance by Hazel Rhodes. The Survey was carried out in the context of the CCET country-specific programme for Romania, and was presented at a meeting of the Economic and Development Review Committee on 2 December 1997.

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Assessment and recommendations

The dire background of transition

The starting point for the transition process in Romania was, in many respects, more difficult than in other countries in central and eastern Europe. Pre-transition policies emphasised self-dependence, putting excessive focus on heavy industry and large infrastructure projects. This strategy led to the depletion of domestic energy sources, and induced costly dependence on imports of energy and raw materials. During the 1980s, the quick reimbursement of a US$11 billion foreign debt (20 to 30 per cent of GDP) imposed severe constraints on the population. As there was no growth in exports (in dollar terms), in order to repay the debt imports from the west were cut roughly in half over the decade. The technological lag increased significantly as a result. Towards the end of the 1980s the Romanian economy was on the verge of collapse and, unlike other transition economies, no attempts to reform had yet been tried.

The gradualist strategy could not work...

Given this difficult legacy, the dominant political forces in place since the early 1990s advocated a gradualist approach, seeking to minimise the social costs associated with the transformation to market. While social concerns were understandable, this strategy was ill-conceived and failed to produce sustainable gains in either economic or social conditions. Indeed, given the experiences of the last seven years, the costs of a gradual strategy have probably been higher than if a bolder approach in structural transformation had been adopted at the outset.

... as anticipated by the 1993 OECD Economic Assessment of Romania

The 1993 OECD Assessment of the Romanian Economy pointed out clearly the risks associated with delaying structural reforms. A key point in the Assessment was that, without deep restructuring of the economy, macroeconomic stabilisation could not be sustained. These crucial linkages may have been overshadowed for a while by the boost in exports and resumption of growth in 1993, and the apparent success in reducing inflation under the stabilisation policy of 1994.

The problems arising from the lack of restructuring were demonstrated by the current account and exchange rate crisis of end-1995...

The risks of the gradualist strategy materialised in 1995. The export performance achieved in 1993-94 could not be sustained. It was based to a large extent on unrestructured heavy industry heavily dependent on imports of energy and raw materials. In order to support energy-intensive industries and allow them to import their production inputs, foreign exchange was allocated to these favoured sectors on the basis of a non-market ''official'' exchange rate and rationed to other sectors. The overall excess demand for hard currencies led to the development of parallel black market exchange rates. Towards the end of 1995, the need for energy imports was aggravated by one of the coldest winters of the century. The significant deterioration of the current account deficit resulted in a fall in confidence in the currency, and the authorities were forced to accept a sharp depreciation in the official exchange rate in November.

... and by the rapidly growing budget deficit during 1996

While output continued to grow in 1996, fiscal policy was derailed under the impact of a largely unrestructured economy. The official budget deficit (on an accrual basis) almost doubled to 5.8 per cent of GDP compared with 1995. Including quasi-fiscal items, such as the National

Bank of Romania (NBR) refinancing of credits to the agricultural sector, the overall public sector deficit surged to over 10 per cent of GDP. This slippage resulted from pre-election policies in support of output and demand and a pervasive lack of financial discipline in large state-owned companies. With rapid growth of the money base, inflation accelerated from 28 per cent at end-1995 to 57 per cent at end-1996, and was rising at a 10 per cent monthly rate in December. Dissatisfied with the slow pace of reform, the IMF and World Bank halted their financial support.

The 1996 elections radically changed the orientation of policies

Against this background of growing economic imbalances, a shift of popular support resulted in a coalition of opposition parties coming to power in the parliamentary elections of November 1996, and the election of a new President. The new administration received a strong political mandate to implement wide-ranging structural reforms. Given the precious time that had been lost in the first seven years of transition, the authorities faced strong pressures to implement reforms at a rapid pace.

A new macroeconomic stabilisation programme was designed...

After re-establishing dialogue with the international financial organisations, the new government negotiated a package of financial assistance and in early 1997 committed itself to a ''shock therapy'' programme of both macroeconomic and institutional reforms. A broad legislative package of over one hundred laws was put forward to be adopted in the course of 1997. Early priorities were to liberalise some important prices that were still under state control (energy, agricultural products and public services), allow the exchange rate to be market driven, reduce import tariffs, remove subsidies and phase out directed credits to the agricultural sector. The stabilisation plan also included a restrictive monetary policy and containing the budget deficit to 4.5 per cent of GDP in 1997 (or 3.5 per cent on an accrual basis). These measures are expected to reduce the current account deficit to under US$2 billion. Recognising the social consequences of these measures, the government sought to protect low incomes by partial indexation of wages and benefits, and increased child allowances.

... together with a wide range of structural reforms

In order to reduce the volume of arrears, estimated at 36 per cent of GDP at end-1996, financial discipline is to be strengthened. The major loss-making state-owned commercial companies will be privatised or liquidated, and restructuring plans for the so-called *Régies Autonomes* (the large utility companies and other public entities under direct control of Ministries) are being prepared. The privatisation of state-owned assets will be speeded up with possibly 60 per cent of the companies privatised by end-1997. At least one commercial bank is to be privatised in early 1998, with others to follow. In the agricultural sector, the system of directed credits was dismantled and replaced by a much lower level of subsidies which are made transparent on a separate budget line. The bans and quotas affecting external trade in agricultural products were also eliminated, and import tariffs reduced from a (non-weig hted) average of 121.7 to 31.8 per cent.

The new government also seeks foreign investment as a way to restructure the economy and facilitate technology transfers. A new Foreign Investment Law has been adopted, which eliminates restrictions on repatriation of earnings, guarantees free transfers of foreign currency for the purchase and sale of assets, and reduces bureaucratic barriers and other regulations. Foreigners have also been granted the right to buy land.

The 1997 stabilisation and reform package is causing a large shake-out in the economy

The speed and scope of the reform package are impressive, even in comparison with other shock therapies adopted in transition countries. There are, however, unavoidable short-term pressures as the heavy dead-weight losses are removed from the Romanian economy. The closing down of companies, lay-offs and disruption of the previous economic networks are provoking social strain. High interest rates and a sizeable fiscal contraction are depressing aggregate demand and investment. Under the impact of tighter financial policies, industrial production had fallen by 18.7 per cent in September 1997 relative to the same month of 1996. Some sectors were particularly hard hit, with output declines reaching 40 per cent (*e.g.* chemicals). This year GDP may fall by around 6.5 per cent. Unemployment remained at a surprising moderate level of around 7 per cent until late-1997, but an increase is expected as the pace of restructuring accelerates. Fortunately, the good agricultural harvest of 1997 will provide an important social buffer given the large share of the population working in or depending on this sector, and the importance of own-consumption of agricultural products.

In the monetary area, monthly inflation accelerated to 30.7 per cent in March 1997 under the impact of price liberalisation, but has since fallen to lower single-digit monthly rates (3.3 per cent in September, but 6.5 per cent in October). On a 12-month basis, the rate of inflation by end-1997 will probably be around 150 per cent. With the ending of directed credits, NBR refinancing (in nominal terms) has dropped to less than half its end-1996 level; reflecting this, the real money aggregates have fallen.

A contractionary fiscal policy is in place

The fiscal deficit for 1997 is targeted at 4.5 per cent of GDP with all off-budget spending eliminated. When a mid-year review of the budget situation revealed slower-than-projected growth in revenues, the deficit target was preserved by further spending cuts amounting to 4 per cent of GDP. The most significant changes in the spending structure are a large reduction in assistance to agriculture and industry, an increase in child allowances, and a rise in interest payments on public debt.

Over the longer term fiscal control could be supported by better management of the budget...

Looking beyond the immediate priority of stabilising the fiscal position, there are several areas of public finances in which there is scope for improvement. For example, weaknesses are evident in the budget management system, including the methods used to forecast revenues and expenditures, and the monitoring and control of budget execution. A more extensive forecasting and prioritisation exercise in the planning stage of the budget should be sought. After approval, the budget should be used as the central financial management tool by government departments. In this regard, departments should develop the capacity to assume greater responsibility for financial control. This would enable the *Cour des Comptes* (the public audit institution) to concentrate less on day-to-day oversight, and more on broader functions such as the audit of public sector performance and evaluation of programmes. Day to day financial management could also be improved through the introduction of a centralised account of budgetary engagements, centralisation of treasury functions and better co-ordination with the National Bank. Reforms in public administration may need to be accompanied, within firm budgetary ceilings, by greater pay flexibility, to give departments the capacity to attract and retain key personnel.

... and reforms to the social security and tax systems

The social security funds are putting increased pressure on the overall fiscal situation, largely as a result of rapid growth in the number of beneficiaries since 1990 and erosion of the contribution base. The reasons for these trends, and possible measures to deal with them, are discussed in more detail below in connection with social policy. In broad terms, there is need for tighter eligibility standards for disability and early retirement benefits, and also clearer criteria regarding access to severance payments. Reforms recently signalled regarding pension arrangements, including setting up a mixed public-private system, should help the long-run sustainability of these benefits.

While the authorities have recently introduced some improvements to the tax system, including modernising depreciation provisions, there is scope for further reforms in this area. The value added tax (VAT) system accounts for a rather low share of public revenues. This system could be improved by reducing the number of exemptions, including those on energy consumption and other public utilities. There are also many exemptions and other special provisions covering customs duties and profit taxes, particularly in connection with the foreign investment regime. While Romania is not unique in offering such incentives, the possible benefits arising from these tax expenditures need to be weighed carefully against their definite costs in terms of lost revenue, administrative complexity, and scope for evasion, abuse and corruption. Streamlining the system of indirect taxes could provide space, in the medium-term, for a reduction in direct taxes on wages and profits. Overall, the goal should be to have a simpler, more transparent tax regime that is neutral in its treatment of different economic activities and sources of income.

A rapid but also sustainable reduction in inflation should be pursued

Turning to monetary policy, the main objective is to achieve a rapid but also sustainable reduction in the inflation rate. This is, indeed, the over-riding concern of the National Bank of Romania (NBR). At the same time, the NBR has sought to counteract the pressures on the exchange rate and domestic liquidity created by the strong pick-up in capital inflows in 1997. The authorities are concerned that too great an appreciation of the real exchange rate in the short-run could reduce the prospects of export-led growth and lead to a subsequent sharp correction. The latter could jeopardise the sustainability of progress that has been made in improving investor confidence and lowering inflation. Hence, the NBR has intervened actively in the foreign exchange market, reflected in a significant build-up in official reserves, and has also been developing (under considerable pressure) monetary instruments to counteract the impact of its interventions on domestic liquidity. As a result of these developments, the nominal exchange rate has depreciated gradually following a period of volatility early in 1997, and the real effective exchange rate appreciated by over 30 per cent in the first eight months of the year.

The impact of this strategy on the exchange rate depends on the extent of support for disinflation coming from other parts of the economy

The NBR's foreign exchange market interventions appear reasonable *provided* this strategy does not compromise the key objective of achieving and maintaining lower inflation. The scope for intervention therefore depends in part on the extent of support for disinflation coming from such areas as wage developments, fiscal policy, and improvements in domestic competition and efficiency. Further real appreciation may occur if there is slower than expected progress with disinflation. Furthermore, the Bank should be prepared to accommodate a rather wide range of fluctuations in the exchange rate according to market-driven influences. Speculative capital inflows can be deterred to some degree if investors perceive downside as well as upside risks regarding the exchange rate. In particular, the NBR should avoid being seen as backing a particular exchange rate and supporting ''one-way bets'' of foreign investors. There are substantial risks with such an approach in a country with a fragile banking system, short-term debt contracts, and institutions heavily burdened by foreign-currency debt. In this context, exchange rate corrections can be abrupt and lead to significant difficulties in the financial sector as a whole (as illustrated by recent experiences in other countries).

The banking system is dominated by state-owned banks with high debt burdens. Restructuring and privatisation, preferably with foreign participation, are required

The impact of monetary policy on the economy – along with the broader processes of economic stabilisation and restructuring – will be crucially affected by developments in the banking sector. Despite the presence of around 40 banks in total, this sector is still dominated by four major state-owned banks. These banks, especially Banca Agricola and Bancorex, are heavily burdened by non-performing loans – mainly a legacy of the pre-1997 policy when the banks were required to provide low-interest (and largely unrecoverable) credits to the agricultural and energy sectors. However, the bad debt problem has continued to grow (or become more transparent) during 1997, as high interest rates, the fall in the exchange rate, and the general economic downturn have strained firms' capacity to repay loans (including hard currency credits). By mid-1997, over one half of total bank credits were in the doubtful or loss categories. The current situation is therefore marked by fragility and uncertainty, with banks charging wide margins, demanding high collateral, and generally unwilling to lend except to large, well-established clients. These problems are compounded by the general lack of experience with risk management and assessment in Romanian banks. The government intends to begin privatising state-owned banks in 1998, and has announced major restructuring packages for the two most problematic banks noted above. It is indeed essential that the banking sector follow the same pace of restructuring as the other sectors of the economy. These moves represent important opportunities to improve market discipline and competition in the sector, and will be further supported by recent improvements in the

NBR's supervisory regime. The new capital and expertise that foreign strategic investors could offer provides a strong argument for including them in the privatisation process, and so the government's intention to have internationally-open sales is to be strongly supported. Beyond this, the contribution of banks to the development of the private sector, particularly through lower interest rates, can be expected to improve gradually as inflation comes down, the fiscal position stabilises, and confidence in the financial sector returns.

Little progress in the privatisation process was achieved until end-1996

Despite two rounds of mass privatisation during the first seven years of transition in Romania, only limited progress had been made by early 1997 in transferring some major areas of economic activity to the private sector. While many small enterprises had been privatised, almost all large industrial enterprises remained under state ownership. In the agricultural sector, most farmland was restored to private ownership in the early 1990s. However, at end-1996, some huge farms, notably pig and poultry, remained under state control, as did the key input suppliers and output distributors. Overall, privatised enterprises accounted for under 20 per cent of the total equity in commercial companies that had originally been assigned to the State Ownership Fund (SOF). Furthermore, the *Régies Autonomes* (which include large ''strategic'' enterprises and public utilities, representing around 20 per cent of employment in the economy) had not even been included in the privatisation programme, and remained largely unrestructured. Similarly, no attempt had been made to privatise the largest banks. As noted above, the financial difficulties in all of these sectors, as reflected in rising payment arrears, bad debts, and reliance on public subsidies, repeatedly undermined efforts at macroeconomic stabilisation in the period from 1990 to 1996.

A bolder approach to privatisation has been put in place...

Faced with this limited progress, the new government has announced a programme aiming to accelerate the restructuring and privatisation of state-owned enterprises, including the previously untouched areas of banking and the *Régies Autonomes*. Complementing this renewed commitment to privatisation are a much more receptive stance towards foreign investment, improvements in the operations and accountability of the SOF, and the government's determination to liquidate non-viable enterprises. The implementation of this strategy is essential for the current stabilisation and adjustment programme to be sustained.

... with both speed and quality of privatisation transactions being important...

The government's privatisation programme for 1997 was ambitious – over 2 700 companies in total, of which 263 are large enterprises (mainly in industry). The programme has run behind schedule, and only around one half of the target will be met by the end of the year. While a range of difficulties and social concerns surrounds the privatisation of large enterprises, maintaining clear progress is vital to signal the government's determination to complete the reform process in this area. Speed is not the only criterion of success, however: quality is also important, notably the transparency and long-run viability of privatisation transactions. Many of the large enterprises are in poor financial shape, and need new strategic owners who have the resources and ability to reinvest and restructure. Attracting such owners, including foreign investors, inevitably takes time but should yield long run benefits.

... especially in the case of major banks and* Régies Autonomes, *where Romania could learn from the experience of other transition countries

The balance between speed and quality of privatisation is of particular relevance in the case of the *Régies Autonomes* and the state-owned banks. Both groups include large entities which will be pillars for the future development of the economy, and this potential should be reflected in the sales' prices (especially in cases such as energy and telecommunications). In order to realise these returns, privatisation has to be preceded by the design of a robust regulatory framework (*e.g.* to deal with monopolistic elements in the *Régies*), and restructuring of banks' balance sheets. In this regard, there is now a substantial amount of international experience with the re-organisation and privatisation of network industries, energy companies and large, indebted banks. Some of this accumulated knowledge may be useful to the Romanian authorities – concerning, for example, the design of regulatory structures, the pitfalls to be avoided, and the sales strategies that seem to be effective. A case in point is the use of ''golden shares'', which have been provided for in the Romanian legislation. As in other countries, the use of such provisions generally stems from political rather than economic considerations. However, golden share clauses come at a price, lowering markedly the value of the assets that are sold. Some countries have ceased to implement these provisions, or at least have ensured that rights associated with golden shares are very narrow and precisely defined. Romania should consider whether national interests as a whole, including that of getting the maximum return from major sales, are best met through golden share provisions.

Overall, the privatisation and restructuring process needs to be better co-ordinated, with clear lines of responsibility defined

Several measures – both institutional and procedural – may help the pace and quality of privatisation decisions to be maintained (or improved). A range of government agencies and ministries appears to be involved – directly or indirectly – in the privatisation process and in the broader process of attracting investment capital to the Romanian economy. The lines of demarcation are not always clear, particularly to foreign investors and others unfamiliar with the organisational details of the public sector. At times, different signals regarding privatisation and restructuring policy have been conveyed by the different agencies concerned, suggesting the need for improvements in co-ordination. The lines of responsibility need to be clearly identified: potential investors should be able to identify their key contact point and know who is really in charge of the process. In this regard, in December 1997, the government signalled its intention to address this issue by forming a Ministry of Privatisation, drawing together the SOF and other agencies involved with privatisation. Furthermore, it is important that the privatisation of the *Régies* not be ''captured'' by the Ministries that were the *de facto* owners of these enterprises, or by the enterprises themselves. Independent control of the process is needed, drawing on expert advice where necessary.

Greater standardisation and decentralisation of privatisation decisions may be feasible

The SOF itself is charged with selling shares in the commercial companies that have been transferred to it, and the SOF's resources appear to be stretched over the many companies in its portfolio. A case-by-case approach is clearly required for large enterprises but, with many smaller companies, further standardisation and decentralisation of the privatisation process may be feasible (especially for companies with only a regional orientation). Important preconditions, however, are that local administrations have the resources and competence to handle such privatisations, and that standard procedures and monitoring systems be established at the national level. Another area where there is scope for improvement concerns the legal and judicial system. For example, there have been several changes in the laws covering privatisation and foreign investment, creating a potentially confusing legal environment; bankruptcy proceedings appear to be difficult and expensive to introduce, and are rarely applied; and the court system is overburdened.

Large loss-making enterprises are under tight budget constraints...

Concerning the restructuring process, the new government announced that some large loss-making companies in the agricultural and industrial sectors would be liquidated, and several lists of companies were circulated to this effect. The willingness of the authorities to use liquidation as a means of restructuring the economy is an important change from past practices. The government is also imposing tough financial conditions on other indebted companies: hard budget constraints are being applied not only to cash *flows* but also to the *stocks* of debts and accumulated arrears. In particular, unpaid tax arrears to the state budget incur heavy penalties.

... but the present profitability conditions should receive relatively more emphasis than the heritage of accumulated losses

However, the assessment of financial viability on the basis of previous losses may be problematic. The previous administered and distorted price system, which included some prices set below average costs, was one of the causes of the financial problems that some companies now face. While imposing hard-budget constraints is an essential piece of the reform package, the authorities should give relatively more emphasis to the current performance of these enterprises than to their performance records under the distorted circumstances of the past.

To ensure benefits from restructuring, competition law enforcement and advocacy should be emphasised

The benefits from restructuring could be delayed if enterprises or public bodies impose restrictions on competition. The Competition Law enacted in 1996 provides an adequate basis for the two competition agencies to oppose such restrictions using competition law enforcement and ‘‘competition advocacy’’ to advise other governmental entities of the likely consumer impact of existing or proposed regulatory activity. To ensure effective, coherent, and consistent competition law enforcement, the Competition Council, an autonomous agency with more powers but fewer resources than the Government’s Competition Office, must in general be able to count on the co-operation of the Office. It is also important that the SOF co-ordinate with the Competition Council both to learn about potential competition problems and to eliminate or minimise the possibility that a privatisation could be delayed. Moreover, support by the Government at the highest levels is necessary for the Council and the Office to be effective in their law enforcement and in their attempts to prevent anticompetitive regulation by public bodies.

SME sector development is an important means to restructure the economy and should not be neglected

While the government is focusing on big enterprises, the small and medium-size enterprises (SMEs) should not be neglected; deep economic restructuring needs the development of a new private sector. Employment creation in SMEs is needed to absorb labour released by the downsizing of large enterprises, especially as restructuring moves ahead. As in all countries, access to financing is a major constraint on the development of private businesses. However, the success of macroeconomic stabilisation policies and further development of the banking sector (*e.g.* with growth of mortgage loans) should help in this area. Even more important, however, would be improvements in the administrative ‘‘friendliness’’ for entrepreneurs. Currently, policies towards SMEs are underdeveloped and are dispersed among several agencies. Improved co-ordination in this area is desirable, possibly with the formation of a single agency with responsibility for SMEs.

Foreign trade has already induced large restructuring in some light industries...

While adjustment in heavy industries has been slow, foreign trade has already induced a substantial restructuring in some light industries. For example, in wood furniture and manufacture of textiles, net employment declined by as much as 40 per cent between 1992 and 1996 (representing 200 000 jobs). This change occurred mainly in the larger enterprises and resulted in a remarkable overall increase in productivity. The problem is that overall employment creation in SMEs has, so far, compensated for only approximately half of the employment decline in large companies.

... and increased inflows of foreign capital should also help the economic restructuring

Also important for economic restructuring is the open stance now in place towards foreign investment, coupled with invigoration of the stock market and start-up of the over-the-counter market. These developments should stimulate private capital inflows, and also contribute to improvements in corporate governance. While a 1.5 per cent transaction tax is applied to foreign portfolio investment, the overall foreign investment regime is rather liberal. Special incentives for foreign investors provided for in the Law may find a justification in the transitional stage of the economy but, as noted earlier, they have a cost and should be phased out over time. More fundamentally, sustained sound macroeconomic policy and large scale restructuring are the most important means to attract capital inflows.

During the present economic adjustment process, social pressures are increasing

Under the impact of the adjustment process, economic hardship is growing: real wages fell dramatically in the first half of the 1990s, and a further decline occurred at the beginning of 1997. The ‘‘working poor’’ have become more numerous, including both urban wage earners and persons who turned to subsistence farming as a temporary solution. There was also growth in the numbers of the unemployed, the under-employed and persons who left the labour market and are no longer looking for jobs. Households relying on public benefits have seen their living standards decline even more than average real wages, due to the fiscal stringency required in the face of shrinking GDP. A reversal of this decline in welfare will rest, in large part, on a rapid and successful restructuring of the economy so that it can embark on a phase of sustainable growth. In the interim, public policies must facilitate the process and shield households as far as possible from extreme hardship. At the same time, policies must promote an equitable sharing of gains and losses during the transition period. But an increasing dispersion of income and wages may well occur during this period; this need not be regarded as a negative development, except to the extent that it is due to further income losses by those who can least afford them.

Social policy needs to be carefully managed to alleviate the most severe economic hardship while also supporting adjustment

In this context, a generous system of severance benefits to laid-off workers can encourage a rapid restructuring of loss-making enterprises. However, this measure in its present form was justified in part by the government’s role as an employer, and should be temporary. Conceived for mass redundancies in a limited set of enterprises, it cannot address more than part of the social problems that result from the economic transition. Where it is used, the programme will require a considerable administrative effort to ensure that it has the desired effect to speed up labour adjustment.

The generally modest income transfers available to other groups must also be administered with a view to enhancing work incentives as well as social equity. In particular, policies should not encourage a heavy use of early retirement or disability pensions. A flow of potentially productive workers out of the labour force has eased the recorded unemployment growth, but entails a long-term cost both financially and in terms of human capital. Some additional spending on unemployment benefits or other temporary income transfers, paid on the condition that the recipients seek work, would be preferable and should facilitate a more limited use of early pensions.

Increasing returns to educational investment are already apparent, and the education system has a key role to play in the years to come. Policies to encourage young people to stay on longer in schooling beyond the primary level and to improve job skills are not only an investment in potential productivity gains, but also a way of minimising labour-market bottlenecks that may emerge in the longer term. In the area of active labour market policies for the unemployed, however, the main priority should be given to cost-effective counselling and job-search assistance.

Means-tested benefits of last resort – social assistance – can be difficult and costly to administer, but they are likely to become more important in alleviating extreme poverty (however this is defined and measured). Child allowances, in contrast, are primarily an acknowledgement of the importance of raising a future generation, and cannot by themselves serve as a well-targeted mechanism for reducing poverty. Like pensions – which still account for the lion's share of social transfers in Romania – child allowances are not simply a means to reduce poverty, but help to prevent it.

The current adjustment process will be difficult but this should not deter the government from pursuing structural reforms with determination

In sum, the Romanian authorities have embarked on an ambitious but long overdue programme of economic reforms. The adjustment process will be difficult over the next few years. Much like a second transition shock, economic activity is contracting as a result of macroeconomic stabilisation and structural reform; as in the first transition, it may take some time for a strong rebound in activity to occur. Nevertheless, this strategy is the only viable option for the government if it is to build the basis for sustainable growth: the costs of slowing down or retreating from the current programme would ultimately be higher than the costs of persevering. Looking ahead, the development potential of Romania is widely recognised. With better management of its endowment of natural and human resources, Romania could join the ranks of the well-performing emerging market economies.

I. Background, economic developments and outlook

A difficult starting point

While Romania is often portrayed as a poor country, this image does not do justice to its large development potential. With over 22 million inhabitants, Romania has the second largest population (after Poland) in Central and Eastern Europe and a large stock of skilled labour. It also has a generous endowment of natural resources, notably including energy and agricultural land. Economic conditions in some areas are comparable with those of more advanced countries in the region. Romania has also known some periods of rapid growth and economic prosperity in the past.

The economic choices of the communist regime which lasted until December 1989 led to the development of gigantic industrial units heavily dependent on the over-depletion of domestic energy resources as well as on imported energy and raw materials. Affected, as an importer, by the first oil shock and having borrowed heavily abroad, Romania had a sizeable foreign debt and interest burden in the early 1980s. Following the decision to rapidly reimburse the external debt (almost US$11 billion) economic autarky was reinforced. As a result, imports of investment goods were cut, the technological lag was aggravated and the pauperisation of the population increased dramatically. Towards the end of the 1980s, the Romanian economy was on the verge of collapse.

Moreover, Romania remained excluded from the economic reform debate which characterised the 1980s in other socialist countries. The transition shock was, therefore, particularly large. In two years, GDP fell by around 20 per cent and industrial output by more than 50 per cent. In the immediate outset of transition, Romania not only lost most of its former COMECON market but was also affected by the UN sanctions against other traditional export markets such as

Iraq and the former Yugoslavia. The most critical factor, however, was the inherited supply structure that was unresponsive to a new system driven by consumer demands.

A gradualist strategy for structural reform was inadequate

A gradualist approach to structural reforms was adopted by the dominant political forces in place since the early 1990s. This strategy was intended to minimise the social costs of transformation of the previous economic and institutional structures. The first seven years of the transition process revealed that this was not a successful approach to reform in Romania.

A critical assessment of the early transition policies was provided in the 1993 OECD Economic Assessment of Romania[1] (Table 1). This Assessment acknowledged that, in spite of a widespread perception to the contrary, during the period 1990-93 Romania had in fact undertaken important reforms. At the same time, the report also urged the authorities to adopt a bolder and more coherent approach to reform because the costs associated with the gradualist strategy were in fact expected to be high. The main point was that macroeconomic stabilisation could not succeed without supportive structural reforms which had to proceed in parallel to be successful. The crucial importance of this policy message was to be reinforced by the economic experiences of Romania in the subsequent four years.

The new government programme

The outcome of the elections of November 1996[2] radically changed the political landscape of Romania and the orientations of economic policy. The new coalition received a strong political mandate to accelerate the pace of structural reforms. In February 1997, the government put in place a ''shock therapy'' programme of reforms that was ambitious both in scope and speed, notably in the legislative area. However, precious time has been lost over the first seven years of transition. The costs of past policy choices are to be borne by the painful adjustment process that the Romanian economy now needs to undergo.

A centrepiece of the new government programme is a legislative package of over one hundred laws which is being adopted in 1997 (see details in Annex I). This reflects both the necessity of building up a new legal framework, and the

Table 1. **Key messages of the 1993 OECD Economic Assessment of Romania**

OECD recommendations in 1993	Observations
I. Price liberalisation	
– Reduce monopoly power, enhance competition. – Remove administrative allocation of goods and services.	A new Competition Law passed in 1996 and a Competition Office and Council were created. Most of the administrative allocations were removed only in 1997. Agricultural and energy prices were liberalised in February 1997.
II. Fiscal and monetary policy	
– Start planning for future pressures on social expenditures and the decline of tax revenues related to lower inflation. – Reform the accounting and tax systems in order to increase depreciation allowances and lower taxes on inventory valuation profits from inflation.	There is still poor collection of taxes. In 1997, the accounting system was reformed to allow accelerated depreciation allowances. The FIFO method for evaluation of stocks is still in place. The taxation of overall income is still to take place (planned for January 1999).
– Financial discipline, enhanced role of price mechanism and full convertibility for current account transactions are the basic ingredients for reform of the exchange rate policy. – A more active role of interest rate policy is needed.	A market-oriented exchange rate regime was implemented early 1997. A new National Bank Law was passed in 1997, which allows for a more active role of interest rate policy.
III. Co-ordination of the reform process	
– The legislative process tends to be overwhelming. – There is poor co-ordination among Ministries and excessive minutiae in the decisions of the Council of Ministers. – The creation of a Ministry of Economic Reform may help to improve co-ordination among the different agencies dealing with privatisation. – There is a tendency for the different Ministries to be secretive with each other, and there are information transmission problems within the government.	While there is a need for building-up institutions, the tendency for intensive legislative activity remains. The Council for Economic Reform and related Agencies are under restructuring. The level of information diffusion in the Administration is still low.

Table 1. **Key messages of the 1993 OECD Economic Assessment of Romania** *(cont.)*

OECD recommendations in 1993	Observations
IV. Privatisation, Restructuring and Financial discipline	
– The privatisation process should remain decentralised. – MEBOs (Management-Employee buy-outs) may help to speed up privatisation. – Remove the substantial barriers to the development of SMEs.	An attempt was made to accelerate the privatisation process in 1996 via the Mass Privatisation Programme. MEBOs were used, but the experience was mixed. The decentralised approach was in practice difficult because the State Ownership Fund plays a major role in selling state assets. Substantial administrative barriers remain for the development of SMEs.
– Macroeconomic stabilisation cannot be sustained without economic restructuring. – Make prudent use of export promotion policies. – Use private incentives for restructuring. – Implement management contracts. – Banks should be involved with restructuring. – Some capital-intensive companies may need ''special'' treatment.	Economic restructuring took place rather slowly during the period 1993-96. The restructuring of the mining and petrochemical sectors is currently under way. The implicit subsidisation of certain energy intensive exports was terminated in 1997. Export promotion policies are hampered by the shrinking budget. A new Law on management contracts was adopted in August 1997. So far, banks have been reluctant in suing their debtors or making use of equity vs. debt swaps.
– Identify and close down the small number of large loss-making companies. – Effective implementation of bankruptcy law is needed. – Remove protection of foreign exchange credits in case of bankruptcy.	Effective liquidation/privatisation procedures were announced in early-1997. Ordinance on restructuring of *Régies Autonomes* in July 1997. Progress still to be made on the implementation of the bankruptcy law. New bank bankruptcy law passed on August 1997. The protection of foreign exchange credits was removed.
V. Social protection	
– Streamline the system of social protection in order to free-up financial resources for investment. Target social benefits rather than consumption subsidies. – Use the surplus of the Unemployment Fund to promote labour mobility rather than to support the budget. – Unemployment risks being concentrated on new entrants, and youth unemployment has to be addressed specifically.	All consumption subsidies were removed in 1997, except basic household heating services and electricity. The main social measures accompanying the 1997 stabilisation plan were indexation of low revenues and child allowances. No specific measures were taken concerning the Unemployment Fund. Active labour market policies have been limited in scope.

fact that, traditionally, Romania has had a quite ''legalistic'' approach to policies. Laws have to cover each matter of detail and also need complicated ''methodological norms'' providing guidelines regarding their implementation. The adoption of a confidence vote by the Parliament in June 1997 enabled the government to accelerate the reform programme by using a fast-track system of ''Emergency Ordinances''; these can be introduced without prior approval by the Parliament, although *ex post* control is applied.

The legislative package covers reform in product markets, the tax system, social security, financial discipline, financial markets, privatisation, enterprise restructuring, public administration, the energy sector and the environment. As indicated by the ranking in Annex I, the first priorities were to achieve full liberalisation of prices (energy, agricultural products and public services), reduce tariffs, remove subsidies and phase out directed credits to the agricultural sector. These measures were immediately followed by a set of partial indexation rules aimed at protecting low incomes from the inflationary effects of price liberalisation (see below). At the macro level, the central bank tightened monetary policy, and the government committed itself to cut the budget deficit to 4.5 per cent of GDP for 1997 (see chapter II). The government expects these measures to help reduce the current account deficit to below US$2 billion.

According to the government programme announced in early 1997, structural reforms would be directed mainly towards:[3]

- **strengthening financial discipline:** reducing the volume of financial arrears – estimated at around 36 per cent of GDP at end-1996 – by privatising or liquidating the major loss-making state-owned companies and preparing the restructuring plans for the *Régies Autonomes* (RAs), including enhanced competition when appropriate;
- **reforming the agricultural sector:** reduction of subsidies and enhanced competition through price liberalisation and further expansion of the privatisation process; establishment and development of the land market; tightening of the financing mechanisms and measures for the re-deployment of labour to non-agricultural jobs. Reduction or elimination of external trade barriers affecting agricultural products;
- **promoting foreign investment:** adoption of new laws eliminating restrictions on repatriation of earnings, guarantee of free transfers of

foreign currency for the purchase and sale of assets, and elimination of bureaucratic barriers and other regulations;

– **speeding-up and enlarging the privatisation programme:** privatising by the end of 1997 a cumulative total of 60 per cent of the companies in the initial portfolio of the State Ownership Fund (SOF). Transform the *Régies Autonomes* into commercial companies in preparation for their privatisation and start the privatisation process of banks. Streamline the institutions dealing with privatisation;

Perhaps the most challenging decision of the new government was the announcement that the large loss-making companies in the agricultural and industrial sectors should be closed down. Several lists of enterprises were circulated, raising debate in the mass media. The government is imposing tough financial conditions: hard budget constraints are being applied not only to cash *flows* but also to the *stocks* of debts and accumulated arrears. In particular, unpaid tax arrears to the state budget incur heavy penalties.

Despite a genuine effort to cover a wide range of reforms in a short period of time, the gap between legislation and effective implementation can be substantial. This is related not only to complexity of the legal texts but also to the lack of an institutional framework and adequate skills in public administration. These issues will be further addressed in chapter II.

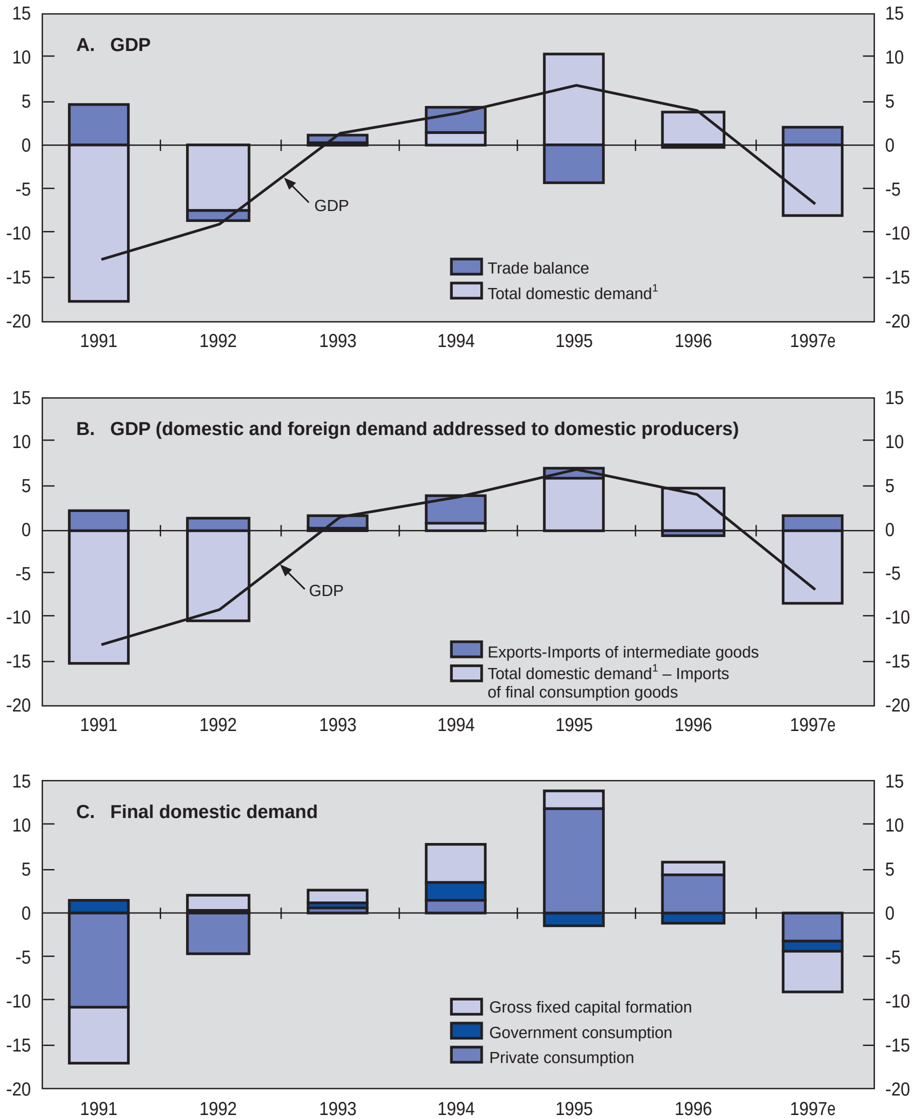
Recent macroeconomic developments

Foreign trade: engine of recovery but also a source of tension

After the initial transition shock, GDP growth became positive in 1993 and peaked at 7.1 per cent in 1995. This recovery was by and large driven by exports (Figure 1). Benefiting from the export push, industrial production grew – with large fluctuations[4] – at an annual rhythm of 8-9 per cent during the same period (Figure 2).

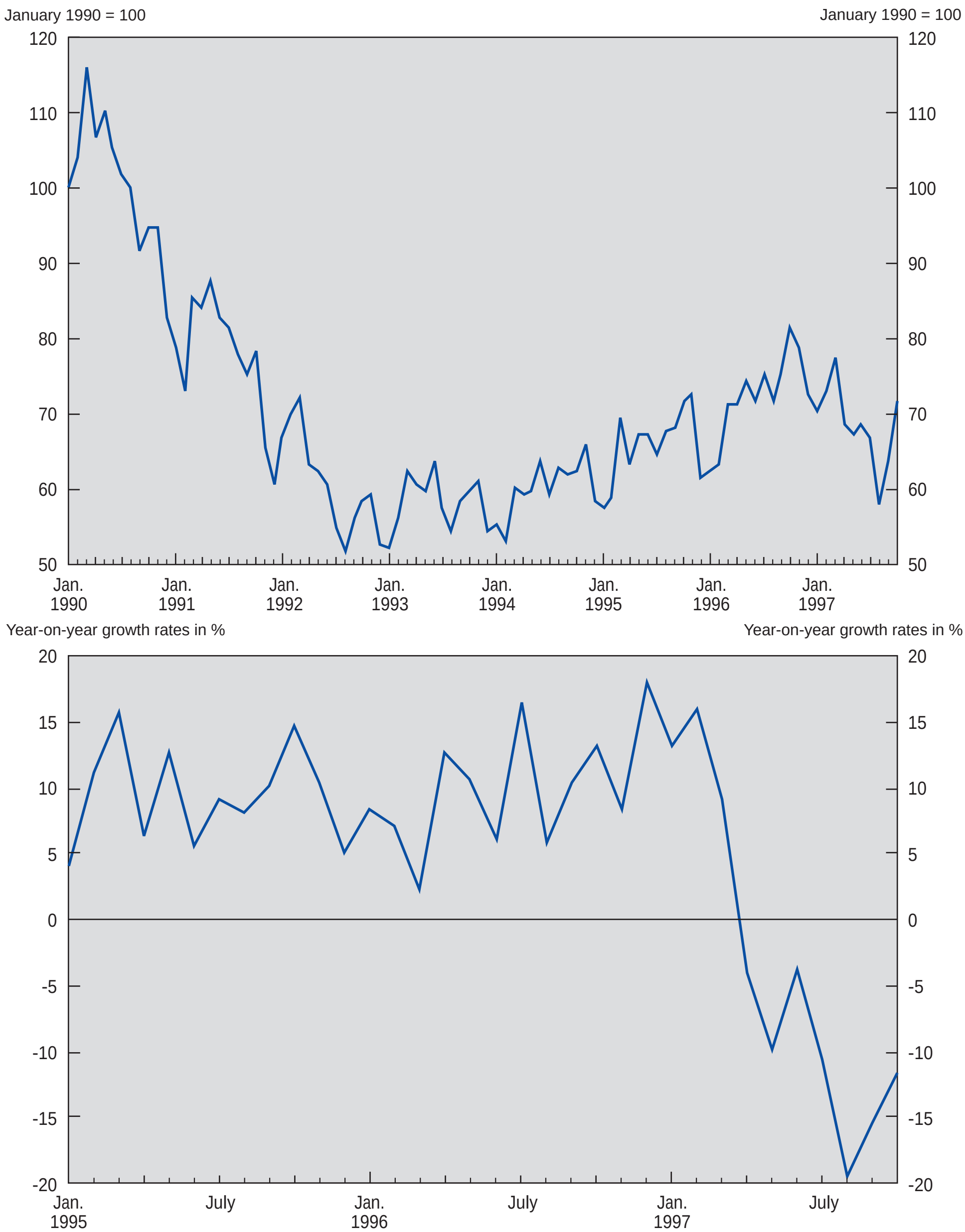
According to the standard breakdown (panel A of Figure 1), 1995 appears to be a break in the export-led growth process. This point deserves closer attention. Indeed, if GDP is instead broken down into net domestic and foreign demand addressed to domestic producers[5] (shown in panel B of Figure 1), the contribution of foreign demand is now positive, although GDP growth still appears to be

Figure 1. **CONTRIBUTIONS TO GDP GROWTH**
As a percentage of GDP in previous year



e. Forecast of the Romanian National Forecast Commission (official).
1. Including stock variation.
Source: National Commission for Statistics and National Forecast Commission.

Figure 2. **INDUSTRIAL PRODUCTION**



Source: National Commission for Statistics.

mainly driven by the domestic component. That the contribution of trade was much lower than in 1994 can be explained by the fact that high export growth required a more than proportional increase in imports of energy, raw materials and intermediate goods, with low value-added being created in the process (more details are given in chapter III and Annex III). In other words, this growth in the context of an unrestructured economy was not sustainable.

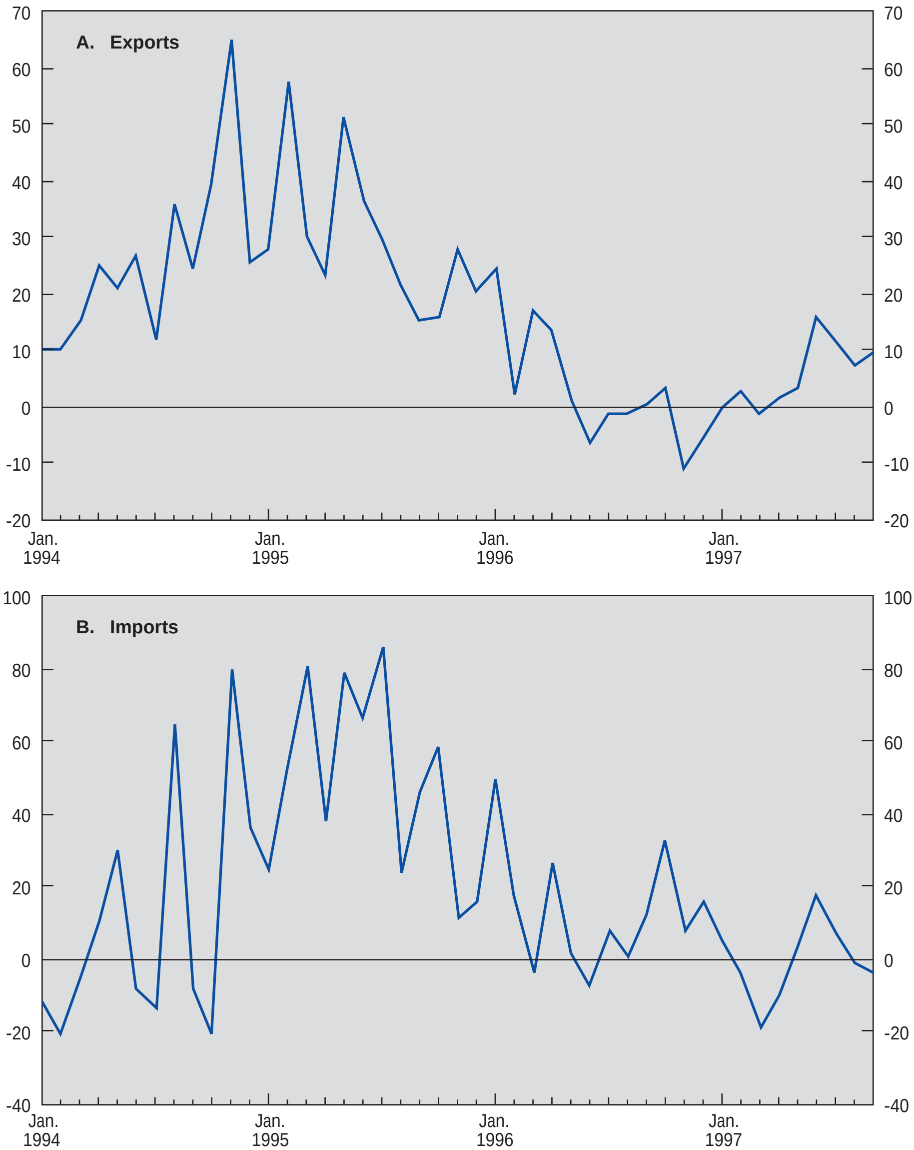
The true break occurred in 1996. After the buoyant 1993-95 period, exports (in dollars) fell (Figure 3),[6] partly under the influence of weaker growth in demand from the main western European markets. The government then tried to stimulate domestic demand (1996 was an election year) with continued support to agriculture through direct credits, subsidies to industry and the artificial stabilisation of the exchange rate. Domestic demand surged particularly strongly for electronic equipment, furniture and textile products as well as for construction activities. The result was that imports continued to grow, generating a soaring trade deficit – US$2.47 billion for 1996 or 7 per cent of GDP. GDP growth declined, but still reached 4.1 for the whole year. Indicating the changing composition of demand, gross consumption increased from 76 per cent of GDP in 1993 to over 80 per cent in 1996, and gross fixed capital formation increased from 18 per cent to 23 per cent of GDP over this period (see Statistical Annex Table A.8).

The shock of the 1997 stabilisation programme

Immediately after the 1997 stabilisation plan was introduced, industrial output continued to grow – somewhat surprisingly – at an average rate of 12.5 per cent in the first quarter against the first quarter of 1996.[7] But the tighter financial policies obliged enterprises finally to adjust and decrease output. In September 1997, industrial production declined by 12.2 per cent compared with the average monthly level of 1996 (or 18.7 per cent compared with September, 1996). Some sectors were particularly hard hit, like food products (–18 per cent in September 1997 relative to September 1996), textiles (–12.2 per cent), leather (–14.4 per cent), chemicals (–32.3 per cent), rubber (–23.7 per cent), machinery (–21 per cent), wood furniture (–14.7 per cent) and electricity and thermal power (–34.7 per cent) (for more details see Table A9 in Annex). While the heavy industries were expected to be seriously affected by the reform programme, light industries and SMEs have also been severely hit, despite signs of positive export

Figure 3. **GROWTH RATES OF EXPORTS AND IMPORTS IN US$**

Year-on-year growth rates in percentage



Source: National Commission for Statistics.

growth (Figure 3). On a month-on-month basis, there are signs of some pick-up as industrial output rose by 8.7 per cent in October relative to September. Overall, GDP is expected to fall by around 6.5 per cent in 1997.

Fortunately, the particularly good agricultural harvest of 1997 provides an important social buffer, given the large share of the population working in or depending on this sector, and also the high own-consumption of agricultural products.

Structural change appears to be limited

Changes in the employment structure are revealing. While in the most advanced transition countries labour resources shifted from agriculture and industry towards the service sector, in Romania the agricultural sector has been acting as a buffer to absorb the downsizing of industry (Table 2). The share of services in total employment is currently only around 30 per cent. Moreover, within the service sector, only in domestic trade (*i.e.* distribution services) has employment been regularly growing.

The private sector share in GDP is growing slowly. By end-1996, it accounted for 52 per cent of total value added. This low share was mainly due, however, to industry. In agriculture and services, 91 per cent and 70 per cent of economic activity, respectively, were in the private sector whereas 65 per cent of industry was still under state control (Table 3). More encouraging, 50 per cent of exports are now undertaken by the private sector. This trend reveals the existence

Table 2. **Employment structure**

	1990	1990	1996	1991	1992	1993	1994	1995	1996
	Thousands	in % of total		Growth in percentage					
Total	10 840	100	100	–0.5	–3.0	–3.8	–0.5	–5.2	–1.2
Agriculture	3 144	29	35	1.9	7.4	5.0	0.9	–10.5	1.7
Industry	4 005	37	29	–5.0	–13.2	–8.2	–4.9	–5.8	1.0
Construction	706	6	5	–29.0	15.6	–0.9	–1.9	–14.9	–0.8
Trade	538	5	8	29.9	7.9	–22.4	8.7	36.0	–10.7
Transport and communication	764	7	6	–9.7	–5.9	–8.8	–6.1	0.0	–1.6
Public education and health	819	8	10	2.1	1.8	0.7	4.4	0.7	0.2
Other services	864	8	7	21.8	–16.3	–8.1	2.7	–14.3	–13.2

Source: National Commission for Statistics.

Table 3. **Share of private sector in economic activity**

In per cent

	1990	1991	1992	1993	1994	1995[1]	1996[2]
Gross domestic product	16.4	23.6	26.4	34.8	38.9	45.0	52.0
Industry	5.7	9.2	11.8	17.4	23.3	29.0	35.0
Agriculture	61.3	73.9	81.7	83.5	89.3	89.0	91.0
Construction	1.9	16.1	21.0	26.8	51.6	60.0	65.0
Services including trade	2.0	16.8	18.8	29.3	39.1	60.0	70.0
Exports (FOB)	0.2	15.9	27.5	27.9	40.3	41.2	51.4
Imports (FOB)	0.4	16.1	32.8	27.2	39.2	45.4	48.3
Investment	4.3	8.1	15.6	26.0	36.8	39.3	41.6

1. Semi-final data.
2. Provisional data.
Source: National Commission for Statistics.

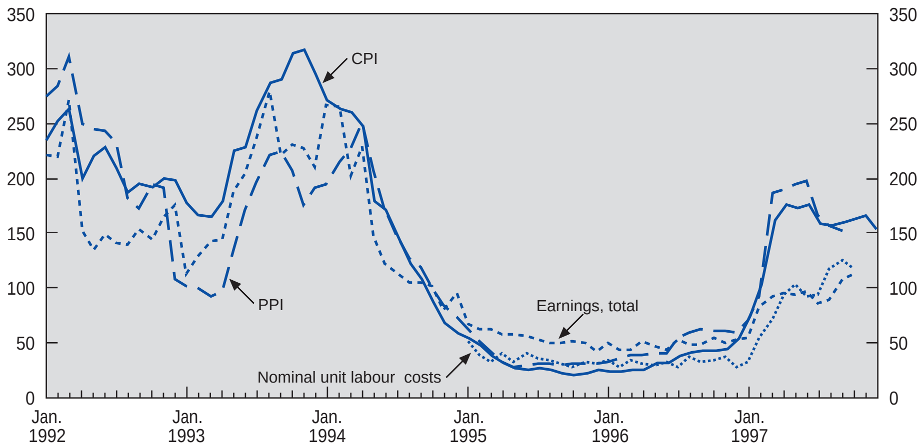
of a rather dynamic layer of small and medium-sized enterprises, particularly in the foreign trade sector (see chapter III).

Only recently has monetary discipline been restored

The stabilisation policy was successful in bringing down the inflation rate from the 300 per cent peak of end-1993 to a rate of 25 per cent in October 1995 (Figure 4). The major policy breakthrough of the 1993-94 period was the dramatic rise of nominal interest rates, which caused real interest rates to become positive in early 1995. This halted the flight from the national currency and contributed to a more transparent foreign exchange market. However, with a growing current account deficit and the depletion of foreign exchange reserves during 1995, a confidence crisis arose in the foreign exchange market and the Romanian leu depreciated sharply in the final quarter.

After the 1995 crisis, the National Bank of Romania (NBR) made another unsuccessful attempt to tighten monetary policy and stabilise the currency. The populist policies of 1996 induced slippage in the fiscal position which the central bank had to finance through money creation. As a result, money and credit continued to expand much faster than nominal activity and annual inflation accelerated to 56.9 per cent by end-1996. The government artificially stabilised the official exchange rate by resorting to administrative measures, but the more

Figure 4. **INFLATION TRENDS**
Growth rate over 12 months



Source: National Commission for Statistics.

market-oriented rate in the foreign exchange bureaux fell during 1996. The spread between the two rates peaked at 30-40 per cent in the final quarter.

The new government started negotiations with the IMF and World Bank in late-January 1997 over a consistent stabilisation and reform package, to be linked with the resumption of financial assistance from these organisations. The NBR started to restore monetary discipline by limiting the quantity of its refinancing funds on offer, and allowing the leu to float freely. In February, the government started to liberalise the prices of energy, public services and agricultural products. Gasoline and diesel prices, which had already doubled in January, rose again by some 50 per cent in February, the price of rail tickets rose by 80 per cent, telecommunications by 100 per cent and electricity by around 300 per cent.[8] After reaching a peak (monthly rate) of 30.7 per cent in March, monthly inflation decreased to a low of 0.7 per cent in July, followed by rates of around 3.5 per cent in the next two months. This apparent progress in bringing down inflation led the NBR to ease monetary policy slightly. This move was premature, however, because, combined with further corrective price inflation and wage indexation, it induced an upsurge in inflation of 6.5 per cent in October, followed by 4.3 per cent in November. These rates were beyond the initial target of 2.5 per cent per month by the end of 1997, and are likely to push the annual rate to around 150 per cent in December.

After the high volatility of early 1997, money markets have calmed down

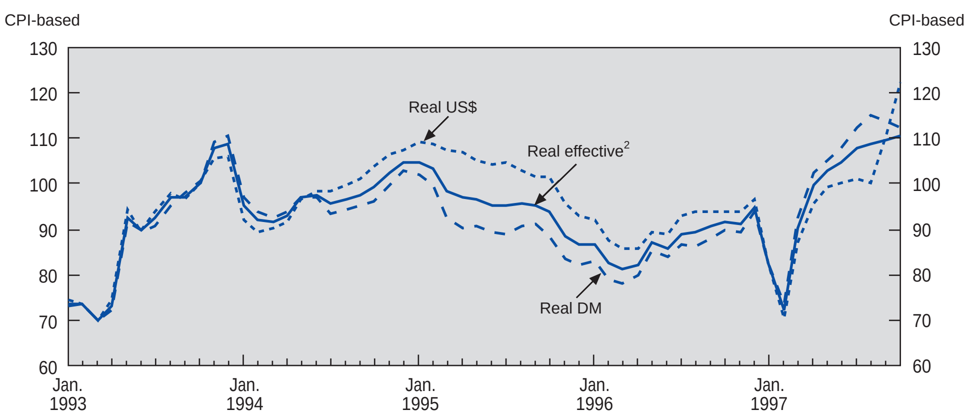
There were spectacular changes in interest and exchange rates during 1997. The auction-determined interest rate on 1-week refinancing funds offered by the NBR peaked at 400 per cent at end-February, but this rate then quickly fell back to 185 per cent in April (when auctions were suspended). Commercial banks' average lending rates have fallen from over 100 per cent in April to 47 per cent in August. Positive real deposit rates have also been restored. The stock of NBR structural refinancing loans to enterprises, farmers and troubled banks is gradually falling. These loans are generally provided at the discount rate (or less), which has been kept at 40 per cent since early-July.

On the foreign exchange market, the leu depreciated from an ''official'' rate of around 4 000 to the US$ at the beginning of 1997 to a high of 9 000 in mid-February. It then recovered to around 7 000 to the dollar, and subsequently rose to close to 8 000 in November. As these recent rates are market-determined, the substantial gap that existed last year between the official exchange rate and the retail rate in foreign exchange bureaux has been largely eliminated. Despite this nominal depreciation, the real exchange rate has appreciated during 1997, more than offsetting the sharp fall at the beginning of the year (Figure 5). This recent appreciation has raised concerns regarding the competitiveness of Romanian industry. Nevertheless, to the extent that productivity growth and restructuring will continue, the low level of wages in Romania may provide a large price competitiveness buffer to industry. The latter may allow some degrees of freedom for the conduct of exchange rate policy. This point will be further discussed in Chapter II.

Foreign trade and payments

As in all transition countries after 1990, a strong redirection of trade flows also occurred in Romania. In 1996, OECD countries represented 65 per cent of Romanian foreign trade, the most important partners being Germany (18.4 per

Figure 5. **REAL EXCHANGE RATE**[1]
1993 = 100



1. Growth in the index denotes appreciation of the lei and *vice versa.*
2. Effective exchange rate (weighted with currency basket: 60% DM and 40% US$).

Source: National Bank of Romania, OECD.

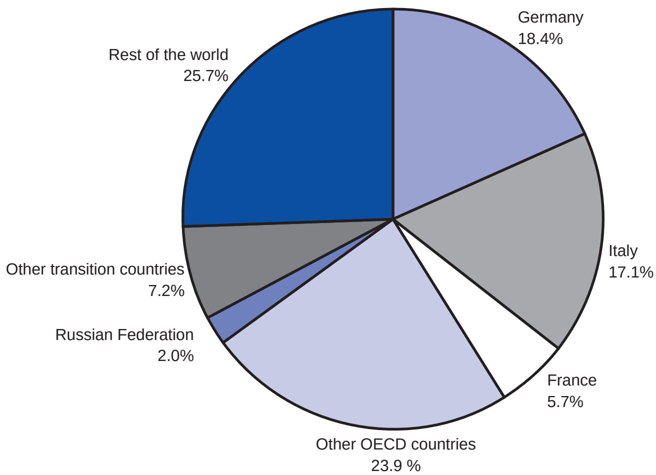
cent of exports and 17.6 per cent of imports) and Italy (17.1 and 15.3 per cent respectively) (Figure 6). The Russian Federation and the other transition countries count for a minor part of trade. In contrast, the share of the rest of the world (including developing countries), which absorb approximately one quarter of exports, has remained important. The overall share of trade (export plus imports) in GDP has increased from 43 per cent in 1990 to 60 per cent in 1996.

A fragile current account position and narrow financing sources...

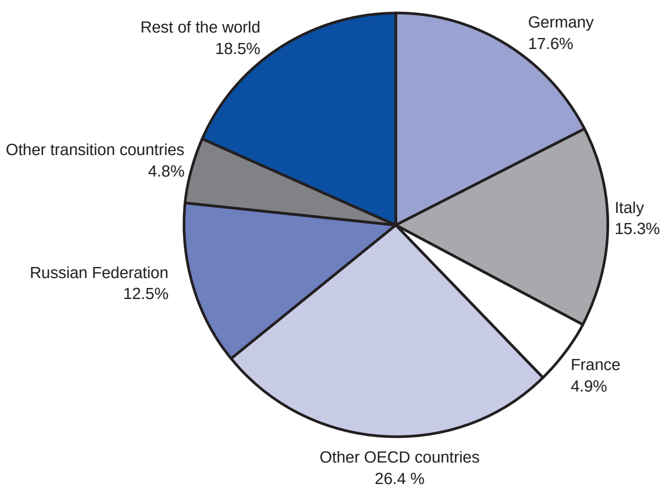
Reflecting a large trade deficit that was not compensated by a surplus in invisible trade, the current account deficit reached US$2.6 billion in 1996 (or 7 per cent of GDP). Striking evidence of this structural weakness of the current account is that Romania is running a deficit even in tourism services. Only net unrequited transfers (mainly workers' remittances) are supporting the current account, with a positive balance of around US$500 million (Table 4). It is noteworthy that the net errors and omissions item has reached major proportions, casting doubt on the overall interpretation of the balance of payments. In 1996, almost US$900 million of credit items were not identified. It cannot be excluded

Figure 6. **FOREIGN TRADE BY COUNTRY, 1996**

Expors fob: 8 084 million US$



Imports cif: 11 435 million US$



Source: National Commission for Statistics.

Table 4. **Balance of payments**

Millions US$

	1990	1991	1992	1993	1994	1995	1996	Jan.-July 1997
Current account	–3 337	–1 012	–1 564	–1 174	–428	–1 774	–2 612	–1 094
Goods and services, net	–3 604	–1 245	–1 588	–1 243	–582	–1 902	–2 855	–1 119
Goods balance	–3 427	–1 106	–1 420	–1 128	–411	–1 577	–2 470	–856
Exports fob	5 775	4 266	4 364	4 892	6 151	7 910	8 085	4 921
Imports fob	9 202	5 372	5 784	6 020	6 562	9 487	10 555	5 777
Services	–177	–139	–168	–115	–171	–325	–385	–263
Credit	610	680	631	799	1 044	1 494	1 563	784
Debit	787	819	799	914	1 215	1 819	1 948	1 047
Income	161	15	–87	–145	–129	–241	–309	–213
Credit	175	104	53	63	116	81	79	60
Debit	14	89	140	208	245	322	388	273
Current transfers	106	218	111	214	283	369	552	238
Credit	138	277	136	231	344	479	634	291
Debit	32	59	25	17	61	110	82	53
Capital and financial account	3 449	872	1 167	1 022	334	1 104	1 721	402
Capital account	0	0	0	8	12	242	100	0
Financial account	3 449	872	1 167	1 014	322	862	1 621	402
Direct investment	–18	37	73	87	341	417	221	652
Credit	0	42	80	94	342	420	223	654
Debit	18	5	7	7	1	3	2	2
Portfolio investment	0	0	–11	–73	75	–21	0	686
Credit	0	0	0	11	112	13	0	739
Debit	0	0	11	84	37	34	0	53
Other investment	1 095	1 526	1 314	1 036	636	765	1 825	252
Credit	1 331	2 147	2 346	2 393	3 034	3 830	4 027	2 340
Debit	236	621	1 032	1 357	2 398	3 065	2 202	2 088
Transit account	0	0	–54	38	3	–51	42	65
Credit	0	0	11	40	36	27	42	65
Debit	0	0	65	2	33	78	0	0
Barter and clearing accounts	529	–504	–268	–128	–115	–505	–53	23
Credit	529	45	91	12	20	17	4	43
Debit	0	549	359	140	135	522	57	20
Reserve assets (NBR)	1 843	–187	113	54	–618	257	–414	–1 276
Credit	1 843	141	366	71	48	327	24	0
Debit	0	328	253	17	666	70	438	1 276
Net errors and omissions	–112	140	397	152	94	670	891	692

Source: National Bank of Romania.

that this could correspond to undeclared current account receipts, given the restrictive foreign exchange rate regime in place up to end-1996.

The bulk of the financing of the current account deficit has been long-term official borrowing both from governments and multilateral organisations, and from banks. Up to end-1996, there was practically no portfolio investment. The reforms that started in 1997 may change the conditions in this respect. The Law on foreign investment adopted in June 1997 provides for a very liberal regime. Basically, a 1.5 per cent tax is applied to portfolio capital transactions. In addition, the acceleration of privatisation and the development of capital markets brought about by government policy may restore confidence in the economy and attract foreign investment.

Capital inflows already picked up during the second quarter of 1997, even if most of them were repatriation of residents' deposits abroad. As a consequence, the total foreign exchange reserves of the financial system have increased to US$4.1 billion as at end-September, of which US$3.6 billion are official reserves[9] (equivalent to 4 months of imports).

... but foreign debt is still moderate

In terms of accumulated liabilities, Romania's total medium- and long-term foreign debt reached US$7.9 billion by June 1997 or less than 30 per cent of GDP. The Romanian state borrowed around US$5.2 billion and guaranteed some US$2.9 billion in foreign loans to state and private companies. Only US$1.2 billion in foreign credits guaranteed by local commercial banks went to the enterprise sector. Foreign private banks (of Germany, Japan, France, Switzerland and Great Britain) hold most of the foreign debt, some US$3.4 billion. International institutions lent US$2.8 billion, of which the International Monetary Fund provided US$613 million and the World Bank US$1.1 billion.

Achieving full current account convertibility in 1997

Efforts towards achieving the convertibility of the leu started at the early phases of the transition. Nevertheless, various forms of official and unofficial restrictions have persisted in the foreign exchange market, at least until recently. For example, as early as 1991, resident enterprises were in principle given access to foreign exchange at the official rate to pay for imports. However, the official rate itself was at times over-valued, with rationing (and hence queues) for foreign exchange being used as the tool for maintaining the over-valuation. Similarly, while the official obligation on enterprises to surrender their foreign exchange revenues to resident commercial banks was abolished in 1992, some large state-owned enterprises reportedly came under pressure in 1996 to turn over their foreign currency earnings. Also in 1996, the authorities revoked the licences of all foreign exchange dealers except for four state-controlled banks, allowing official controls over the exchange rate to be tightened.

In 1997, foreign exchange rationing and multiple currency practices have *de facto* disappeared. The foreign exchange dealer licences that were withdrawn in 1996 have also been restored. Finally, the government announced that Romania would comply in the course of 1997 with the Article VIII obligations of the IMF, by removing the remaining (US$500) restriction on the access of resident natural persons to foreign exchange for travel abroad.

Labour markets and income policy

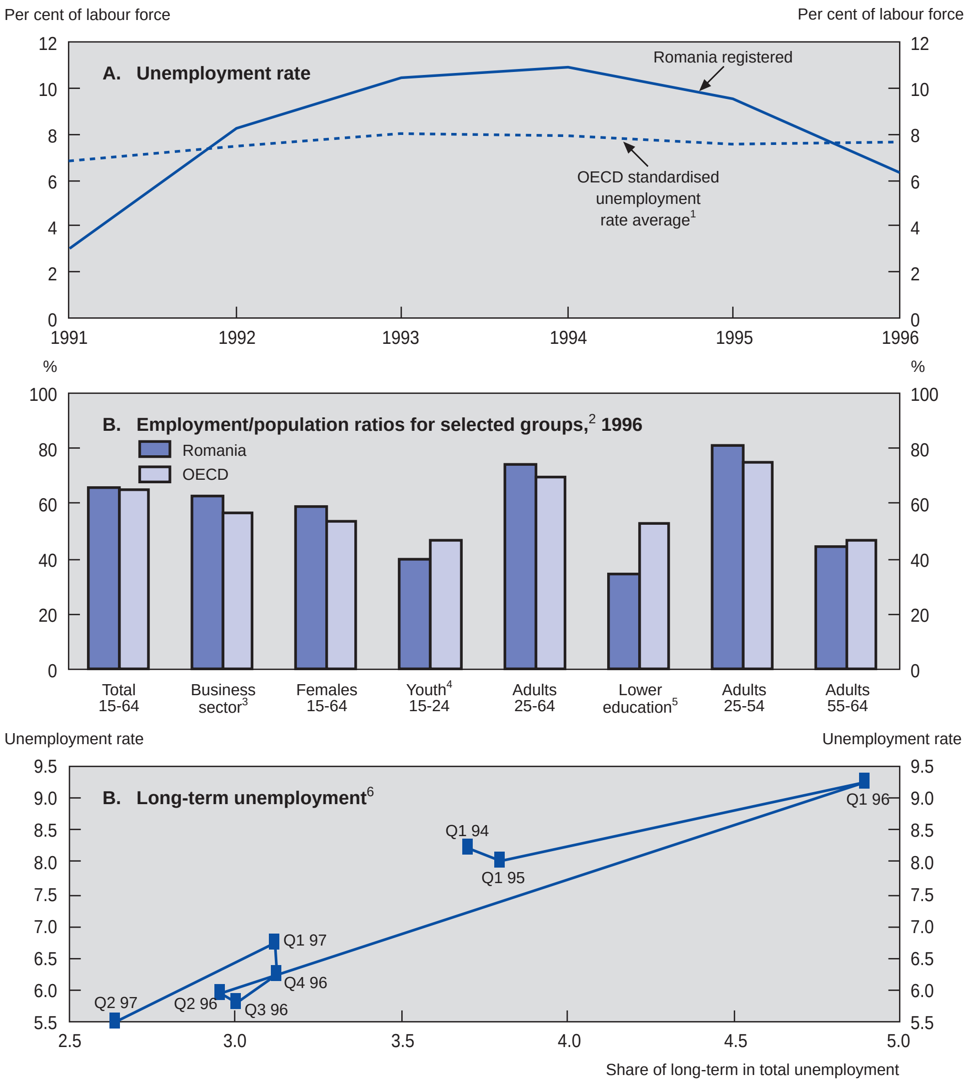
A somewhat puzzling low unemployment rate...

The strong GDP growth of 1995 helped to reduce (registered) unemployment to 9.5 per cent at end-1995, from 11 per cent in early 1995 (Figure 7). In October 1996, the official unemployment rate declined to 5.9 per cent. This further fall during 1996 is somewhat puzzling. Part of the decline appears to be due to administrative efforts to clean up the unemployment rolls. More generally, many unemployed persons are not eligible for benefits and may not bother to register. An alternative unemployment measure based on labour market surveys indicated unemployment rising (from 8 to 9.3 per cent) between the first quarters of 1995 and 1996. However, by the end of 1996 the two measures were almost identical (see more details in chapter IV).

Possible explanations for the unemployment puzzle are the high self-employment in the agricultural sector (see Annex) and a pervasive grey economy, which have absorbed workers laid off from industry. Indeed, self-employment accounted for 37 per cent of total employment in 1996, a very high number by international standards. In the agricultural sector, the number of non-salaried family workers was of the same order of magnitude.[10]

In 1997, registered unemployment was rather stable at just over 7 per cent between February and September, but may well rise to 9-10 per cent late in the

Figure 7. **KEY FEATURES OF THE LABOUR MARKET**



1. Excludes Austria, the Czech Republic, Denmark, Greece, Iceland, Luxembourg, Mexico, Turkey, Hungary and Poland.
2. Defined as the percentage of each population group that is employed. Maximum working age is 64 years.OECD in 1995.
3. Business sector employment divided by working-age population.
4. The minimum age for youth differs across OECD countries (either 14, 15 or 16).
5. Completed less than upper secondary education. OECD in 1994.
6. Long-term unemployment is defined as individuals looking for work for one year or more.

Source: National Commission for Statistics, Labour force surveys, OECD.

year as a consequence of the restructuring process. Massive restructuring has already started in the mining regions. Triggered by the phase-out of state subsidies and the possibility of receiving substantial redundancy payments, employment in the mining sector dropped by about 60 000 workers in a few weeks.

... given the decrease in industrial employment

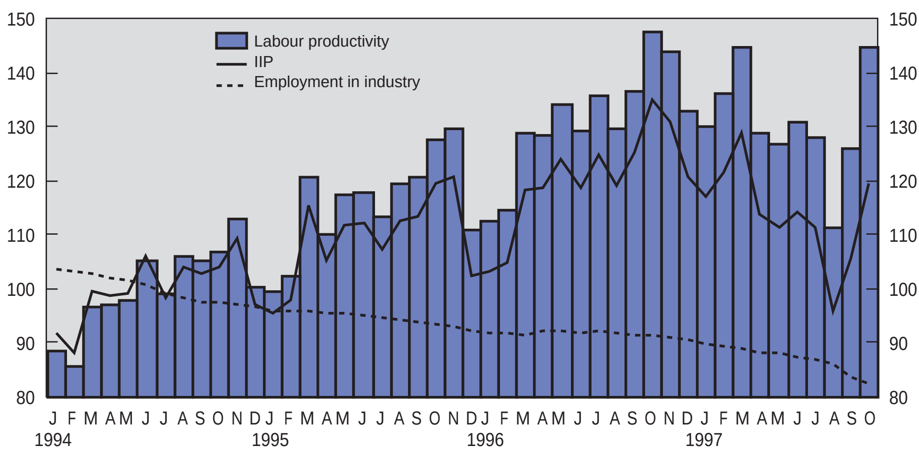
Industrial employment has decreased steadily. Between 1992 and 1996, around 470 000 industrial jobs were suppressed (or 10 per cent of the number of employees). As a result, labour productivity has been increasing (Figure 8). This trend has stalled in 1997 because the recent fall in industrial output has not yet been followed by the downsizing of employment.

Real incomes have fallen sharply

Real incomes increased on average by 9.3 per cent in 1996, reflecting the expansionary policies pursued by the government. On a year-on-year basis, however, nominal net wages were up 42.5 per cent in December 1996 when

Figure 8. **LABOUR PRODUCTIVITY IN INDUSTRY**

1994 = 100



Source: National Commission for Statistics.

compared to December 1995, but the acceleration of inflation to 57 per cent more than offset this increase. In 1997, the soaring inflation rate created additional pressures for wage increases. Taking into account these social pressures, the government decided to adopt a partial indexation policy with an objective of 80 per cent indexation of wages and related incomes for the whole year. In February, net wages were increased by 15 per cent relative to January. All budgetary sector wages were raised again by 15 per cent in August and will be raised again by another 14 per cent in October. The cumulative effect of these increases is largely below the inflation rate: in the year to August 1997, nominal wages increased by 89 per cent while inflation rose by 159 per cent (*i.e.* a real wage fall of nearly 30 per cent). Pensions are to be increased by only 1 per cent more than wages. The minimum gross wage will be fixed at 250 000 lei per month in October (roughly US$33) or 40 per cent of average wages. Moreover, as a way to enforce financial discipline, the government decided that state corporations having debts to the budget will not benefit from these wage adjustments.

Economic outlook

The outlook for 1998 and 1999 is based on the assumption the government will maintain the stabilisation programme and structural reforms will move firmly ahead. So far, indicating the government's determination in these respects, the intermediate steps conditioning the structural support from the World Bank and the IMF have been fulfilled.

Given the rapidly changing economic environment, the short-term outlook for Romania is particularly uncertain. On the positive side several influences could contribute to a pick-up in economic activity in 1998. The stabilisation programme has improved credibility of fiscal and monetary policy. The 1997 budget appears on track, and the official projection for 1998 is a consolidated budget deficit of 3.5 per cent, slightly lower than the 1997 figure and implying a zero primary deficit. Although monthly inflation has recently been volatile, the rate is expected to slow further. Progress in these areas represents a basic pre-condition for sustainable improvements in microeconomic performance. The agricultural sector –comprising 25 per cent of GDP – should benefit from price liberalisation, restructuring of input supply and distribution channels, and reform

Table 5. **Economic outlook**

Indicator[1]	1994	1995	1996	1997e	1998*	1999*
GDP	3.9	7.1	4.1	–6.5	1.0	3.0
Inflation	62	28	57	150	25	20
Unemployment rate	10.9	9.5	6.3	9	10	10
Fiscal balance	–1.9	–2.6	–3.9	–4.5	–3.5	–3.0
– incl. quasi-fiscal deficits[2]	–5.5	–2.9	–6.5	–4.5	–3.5	–3.0
– incl. quasi-fiscal deficits[2] and on accrual basis	–5.5	–3.3	–8.4	–3.5	..	..
Current account ($ billion)	–0.4	–1.8	–2.6	–2.0	–2.0	–2.0

e. Estimates.
* Projections.
1. Output data are average annual percentage changes of real GDP. Inflation data refer to end-year per cent changes in consumer prices. The fiscal balance is expressed as a percentage of GDP. The current account is in US$ billion. Unemployment refers to end-period registered unemployment.
2. Includes refinancing from the National Bank of Romania (see text).

Source: National authorities and OECD Secretariat estimates.

of the land law. Exports, which were the engine of recovery in 1993, should benefit from the stronger market growth, especially in western Europe. In contrast with the previous recovery, the contribution of foreign trade to GDP growth should be more sustainable given that the support for the unrestructured, import-intensive parts of the economy is being phased out. Increased foreign investment – boosted by the stabilisation programme, accelerated privatisation and development of capital markets – is already apparent in some sectors, supporting restructuring. Furthermore, the progressive elimination of a range of negative value-added activities in the economy – usually supported by large subsidies – will also, by definition, contribute to growth.

On the other hand, there are several important downside risks in the outlook. The need to pursue a tight monetary policy, coupled with restructuring requirements of the banking sector, will continue to impose liquidity constraints and high interest rates on the economy. Problems of revenue collection may persist in the fiscal area, further constraining public spending. Restructuring in large state-owned industrial enterprises has just begun and will result in further falls in employment and output in 1998. Liquidation of indebted companies will add to the difficulties of the financial sector, which could create additional pressures on the state budget.

The GDP projections suggest that positive and negative influences on the economy may broadly balance out in 1998 and gradually move towards a rebound in 1999. While a large part of the economy is undergoing substantial adjustment, the basis for private sector development already exists, unlike the situation in the early 1990s. However, nothing would jeopardise the prospects of sustainable recovery more than a retreat from the current reform programme. This would lead to a major loss of confidence in macroeconomic policies and a fall in the financial support for restructuring. The following chapters analyse in more detail the implications of the current government programme. Maintaining coherent links between the macro-stabilisation plan and progress of the structural reforms is the crucial condition for sustainable growth in Romania.

II. Macroeconomic policies

The stance of macroeconomic policies in Romania has been strongly contractionary since the end of 1996. For example, the consolidated budget deficit for 1997 is targeted at 4.5 per cent of GDP, substantially below the deficit of over 10 per cent of GDP in 1996 (including NBR refinancing of directed credits, plus other quasi-fiscal items as explained in Box 2 below). The growth rate of the monetary base fell from 41 per cent in the second half of 1996 to 11 per cent in the first half of 1997, while prices rose by 101 per cent in the latter period.

This tightening of macroeconomic policies is almost certainly contributing to the difficult economic and social conditions in 1997. A supply-side response from the economy could not be expected to offset immediately the effects of macroeconomic contraction. However, the Romanian authorities had little choice but to pursue such a programme. With money aggregates, inflation and quasi-fiscal spending rising rapidly in the latter part of 1996, the economy was on a dangerous and totally unsustainable course. Delaying further the necessary adjustment in economic policies would almost certainly have led before long to a collapse of economic confidence, and forced an even more severe, and potentially more prolonged, contraction in activity.

Moreover – and in stark contrast with earlier years – the corrections in monetary and fiscal policies in 1997 have been complemented by wide-ranging reforms at a microeconomic level. As discussed elsewhere in the Survey, these reforms include extensive price liberalisation, the acceleration of privatisation and restructuring of state enterprises (with the closure of large-loss-makers), and opening up of the foreign investment regime. Structural problems, including the recurring build-up of losses and arrears, have been particularly acute in state-owned agricultural enterprises (see Annex II) and in the energy-intensive industrial sector (discussed further in Annex III). The difficulties of these and other Romanian enterprises can be attributed to a combination of chronic inefficiency and overcapacity; regulatory restraints, such as price ceilings, which distorted market mechanisms and induced reliance (*e.g.* among agricultural firms) on compensating state subsidies; and social concerns, including maintenance of employment and ‘‘food security’’, which deterred the government from persevering with deep structural reforms.

Instead of increasing the pressure for restructuring, the financial difficulties of state enterprises were accommodated until end-1996 through debt relief, low-interest credits (financed directly or indirectly by the central bank), and other forms of state support. Anticipation of further rounds of support, validated by experience, reinforced moral hazard problems in the operation of these enterprises: for example, enterprise managers found they had little to lose by not paying taxes and other debts to the state.

These negative interactions between macroeconomic and structural policies have been a persistent feature of the Romanian economy during the first seven years of transition, and the main reason why progress towards macroeconomic stabilisation in earlier years was limited and unsustainable. In addition, the election campaign in 1996 added further pressure on the government to support loss-making enterprises rather than to pursue structural reforms.

As well as the support being provided from structural reforms, there are several other reasons to be confident that the current macroeconomic programme will be more successful than previous efforts at stabilisation, such as in 1994. For example, in the 1994-1996 period, policy makers underestimated the potential conflict between economic growth and the balance of payments situation: real wages grew too quickly relative to productivity; and insufficient attention was paid to building up foreign reserves, which contributed to recurrent pressures and losses in confidence in the foreign exchange market. In contrast, there is substantial compression of real wages and domestic demand, including public spending, in the current programme. While testing the determination of the government to proceed with painful reforms, these trends should support the sustainability of the expected rebound in activity.

Also important is the open stance now in place towards foreign investment, coupled with invigoration of the stock market and start-up of the over-the-counter market. These developments should be of direct benefit in stimulating autonomous capital inflows, helping Romania to finance trade imbalances and increase foreign reserves; but also – indirectly – such reforms should contribute to improvements in corporate governance and support the role of exports as a driving force in economic growth. And finally, the breadth and speed of the current programme has increased significantly the stock of credibility of the new policy direction. While restructuring still has a long way to run, and tensions persist in the banking sector, the fiscal position, and elsewhere, the positive perceptions of international observers and financial support from the multilateral lenders should assist the government in continuing the reforms.

Fiscal policy

The institutional framework for the budget

The principal budget entities in Romania are the state (representing 64 per cent of general government spending in 1997); the social security fund, which covers old-age pensions and invalidity benefits (14 per cent); and local government administrations, responsible for most local services (excluding health and education, which are centrally funded) and some basic social assistance benefits (11 per cent). There are also several smaller funds, covering additional areas of social support (including unemployment compensation and farmers' pensions) and some more specialised functions (such as energy projects and road construction). The breakdown by budget entity of the consolidated government accounts for the 1997 budget is shown in Statistical Annex Table A11. Compared with the situation presented in the previous Economic Assessment (OECD, 1993), progress has been made in improving the transparency of the budget by bringing former extra-budgetary activities within the scope of the consolidated accounts[11]. However, as shown by the serious fiscal difficulties that arose in 1996, the process of improving financial accountability and discipline in the public sector – and elsewhere in the economy – is by no means at an end. A matter of special concern is the management of the budget, which is far from satisfactory (Box 1).

The fiscal position up to 1996

The fiscal situation in Romania – as presented in the consolidated revenue and expenditure statements of government (Figure 9) – appears at first glance to have deteriorated at a steady but manageable pace between 1993 and 1996. The consolidated deficit grew by around one percentage point of GDP per year – the

Box 1. **Reform in public sector management**

The budget management system

The budget management system in Romania has weaknesses at the level of both budget preparation and execution.

The preparation of the budget begins relatively late in the prior fiscal year (May) and lasts only a short time, as the budget needs to be presented in October. The budget is naturally based on macroeconomic projections and assumptions, but these appear to be of rather limited scope. For example, the macroeconomic assumptions underlying revenue projections are fragile, and the uncertainty in this area is accentuated by several phenomena. These include the underground economy, whose size – at least at a sectoral level –can change in a significant but often unpredictable manner; the instability of fiscal legislation (albeit understandable in a time of substantial reform), making it difficult to establish a fixed relation between the fiscal base and revenue collections; uncertainties regarding the effectiveness of administrations charged with assessing and collecting taxes (despite the number of services with responsibility for fiscal control); and, finally, the sparseness and fragility of information systems. The cumulative effect of all of these factors thwarts the introduction and use of standard fiscal elasticities, which are indispensable tools for all revenue forecasts.

Expenditures are no easier to predict. In reality, no true forecasting exercise is carried out, and the numbers which appear in the budget are the result more of a negotiation exercise, often just approximate. These negotiations are based on the previous year's budget (rather than on actual expenditures in the previous period), augmented by broad-based demands for additional spending, and subject to broad-based constraints imposed by the Ministry of Finance. The final negotiations are done in a meeting of the Cabinet, which appears to enter into a very fine level of detail on these matters – indicating ineffectiveness in the administrative phase leading up to preparation of the budget.

In these conditions, the budget appears to be more an act of political signalling than a tool of management and guidance for the steps that follow. That is why the budget is used as little more than a distant reference for the financial management exercise; this function is guided more by the effective availability of short-term funds than by budgetary authorisations voted at the end of the previous fiscal year. Moreover, in the execution phase, credits are made available to ministries by twelfths, but the twelve twelfths of a year are rarely equal to the total annual budget.

An internal financial control system is essentially non-existent, and the full security of budget execution rests with the *Cour des Comptes,* which controls (by *ex ante* authorisation) both budget commitments and payments. Required by law, this very in-depth involvement of the *Cour des Comptes* in day-to-day budget management has several consequences. In particular, it seems to relieve the ministries, that of finance

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as well as spending ministries, from any real preoccupation with control. Resting on the authority and professionalism of the *Cour*, the administrations develop no genuine system of internal control, hence depriving themselves of valuable tools of management and guidance. Besides, in concentrating a significant part of its resources on this type of control, the *Cour des Comptes* cannot orient itself towards the development and audit of performance and evaluation of government programmes, functions which no Romanian institution currently fulfils.

Aware of these difficulties, the Romanian authorities have been undertaking an in-depth assessment of the role of the *Cour* and the development of a financial control system; it is to be hoped that this will soon lead to substantive changes.

Development of the essential internal financial controls is, in addition, held up by the absence of any centralised account of budgetary engagements. Each ministry maintains an account of commitments according to its own rules and methods; there is no centralisation. It is not surprising therefore that arrears build up, as a natural ''mechanical'' solution to reconcile any gap between commitments and payments. Naturally, this absence of centralised reporting of budgetary engagements limits the effectiveness of short to medium-term forecasts of treasury activity. The problems this situation creates for day-to-day liquidity management are noted below in the section on monetary policy.

While it is not possible to go beyond suppositions on this point, given lack of information, centralisation of treasury functions would merit a detailed examination for several reasons. In part, it appears that some administrations, government agencies and extra-budgetary funds are not integrated in a ''unique account'' of government, and use their own treasury as a result. Moreover, it is not certain that all the funds allocated through the unique account are subjected to a daily clearing operation, such that unused pockets of treasury funds probably remain. A significant part of deposits and payments is made in cash, the management of which is difficult, constraining and costly. Finally, concerning transfers intermediated through the banking network, it would be useful to measure the loss of treasury resources due to delays in payment.

The Romanian government has no doubt become aware during 1997 of both the fragility but also the cumbersome nature of its budget management system. However, it is clear that, at the time of preparing this survey, the necessary improvements are still just at the stage of study and preliminary consideration. In any case, strengthening the administrations charged with management of public finances in Romania appears to be the key to pushing this matter ahead and introducing the required structural reforms. In particular, improving operations in the Ministry of Finance, including building up the quality and probably also the numbers of personnel in certain areas, is an essential pre-condition for profound, sustainable improvements.

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Public administration

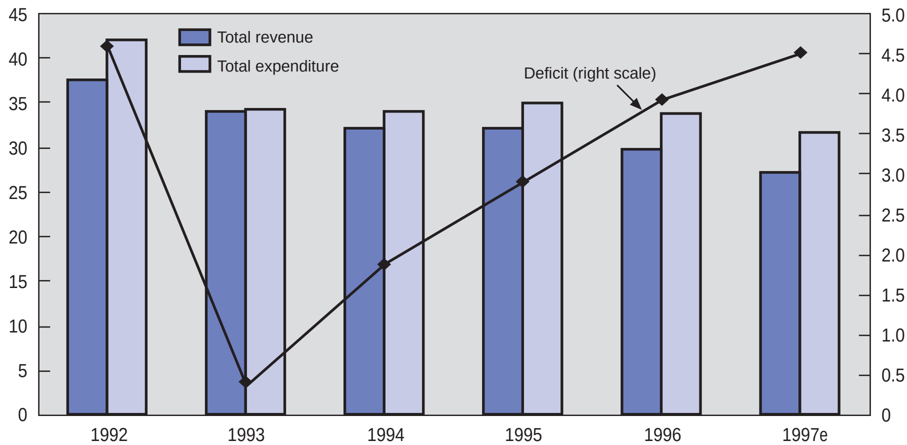
The Romanian Government has defined reform of public administration as one of its priorities. The strengthening of the administrative capacity and of the government decision-making process is essential for the development of policies, especially in the economic area. The reform is important also for carrying out the functions of a democratic state and for applying the *acquis communautaire,* as pointed out in the European Commission's Opinion on Romania.

Among the first law projects related to Public Administration Reform is the preparation of a bill on The Statute of the Civil Servants. The final version of the law is currently being drafted (September 1997) after interministerial consultations, and the bill is intended to be submitted to Parliament before the end of this year. The rationale for the Civil Servants Act is to establish a legal foundation for a professional and neutral Civil Service in the Romanian administration. Such a law is regarded by many as a necessary and urgent means to professionalise and stabilise the Romanian administration and to improve its performance. The draft law defines a very decentralised system, in accordance with Romanian administrative traditions, where every branch of government will be recognised and managed as a separate civil service. The law will, in addition to covering officials in the state administration, cover Local Government officials, both politically elected and appointed ones, as well as the political appointees in the ministries.

The generous scope of the draft law, in combination with transitional provisions that will enable most current employees to become subjects to the law, will have an impact on the state budget both by raising short term expenditure on personnel and by creating long term liabilities in the form of pension promises included in the draft law. It is unclear if all of the raised or new remuneration benefits will remain in the law once it has both passed the Council of Ministers and the scrutiny process of the two chambers of Parliament. But it is anyway reasonable to presume that the law will imply some increased costs, which – in order to be funded – probably will have to lead to increased restructuring and downsizing efforts.

result of declining revenues (as a share of GDP) rather than expenditure growth. Total revenues fell to 30 per cent of GDP in 1996 compared with 32 per cent in 1995 and 42 per cent in 1991. Total expenditures – according to the official budgetary data – have been around 34 per cent of GDP since 1993, a relatively low ratio compared with most OECD and central European economies and substantially down from the 42 per cent level of 1992. The latter decline is largely attributable to falls in direct budgetary subsidies to enterprises and other organisations. Moreover, Romania began the transition process with a relatively

Figure 9. **CONSOLIDATED GOVERNMENT BALANCE**
Percentage of GDP

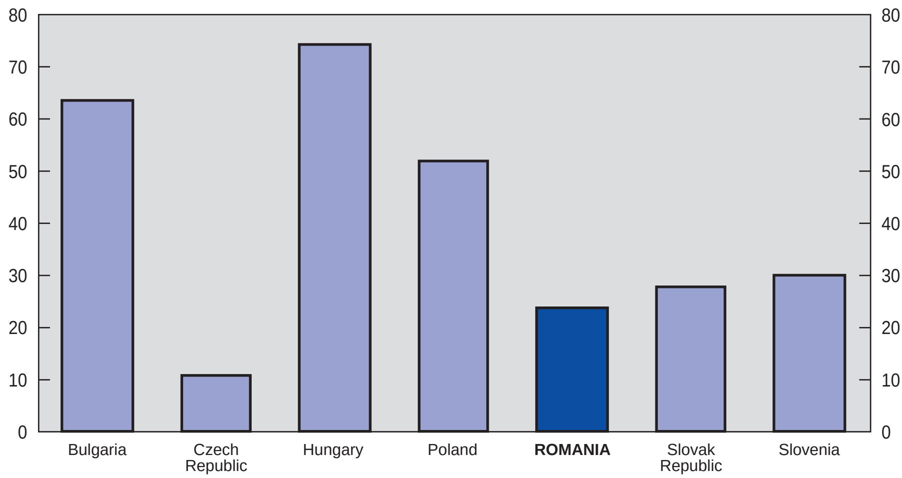


Source: Ministry of Finance.

low level of public debt and, despite recent growth, still has a debt to GDP ratio well below that of its neighbours and of many OECD countries (Figure 10). On this basis, the fiscal trends of recent years might not raise significant alarms.

However, the standard consolidated accounts present only a partial view of the overall budgetary picture. In particular, they do not capture the full extent of deterioration that occurred in 1996, and the size of fiscal contraction that is effectively in place in the 1997 budget. Three points need to be noted in this context. *First*, the deficit outturn of just under 4 per cent of GDP in 1996 compares with projections of a 2.2 per cent deficit in the initial budget plan. The budget was revised three times (in August, November, and December), with the most substantive change involving a downward revision to projected revenues from the corporate sector (these were revised down by 1 300 billion lei in August, or around 1.2 per cent of GDP). The deficit arose primarily in the state budget: a deficit here of 5 per cent of GDP was partly offset by a surplus of 1 per cent of GDP in the unemployment fund. In addition, however, just over 300 billion lei (0.3 per cent of GDP) was transferred from the state budget to the social

Figure 10. **GROSS PUBLIC DEBT IN PERCENTAGE OF GDP, 1996**



Source: National statistics offices, OECD.

security fund to cover a shortfall in the latter – this arising in part from arrears in company social security payments, but also from structural problems in the area of pensions (see below). The government's initial intention was to finance its deficit through 90 per cent off-shore finance and 10 per cent domestic; however, the cost and availability of credit eventually led to the deficit being financed almost entirely through domestic sources (net credit to government grew by 3.5 per cent of GDP between end-1995 and end-1996).

Second, several sizeable public expenditure items due in 1996 were carried forward to 1997, including subsidy payments to farmers and the 13th monthly salary owed to public sector employees. Taking these items into account, the consolidated deficit in 1996 measured on an *accruals* basis rises to 5.8 per cent of GDP (Table 6).

Third – and of greatest significance – a large volume of *quasi-fiscal* support was provided to the economy in 1996 (which does not show up at all in the consolidated accounts). For example, there was a rapid increase in directed lending to state-owned agricultural enterprises, financed at below-market interest

Table 6. **Fiscal and quasi-fiscal deficits**

As per cent share in GDP

	1993	1994	1995	1996	1997
Budget balance					
Total					
Cash	–0.4	–1.9	–2.6	–3.9	–4.5
Accruals	–0.4	–1.9	–3.0	–5.8	–3.5
Primary					
Cash	0.6	–0.5	–1.2	–2.2	–0.5
Accruals	0.6	–0.5	–1.6	–4.1	0.5
NBR refinancing	–3.1	–3.6	–0.3	–2.6	0.0
Budget balance including NBR refinancing					
Total					
Cash	–3.5	–5.5	–2.9	–6.5	–4.5
Accruals	–3.5	–5.5	–3.3	–8.4	–3.5
Primary					
Cash	–2.5	–4.1	–1.5	–4.8	–0.5
Accruals	–2.5	–4.1	–1.9	–6.7	0.5
Memorandum item:					
Interest payments	0.9	1.4	1.4	1.7	4

Source: National Bank of Romania.

rates by the NBR. Further details on this extra-budgetary spending are provided in Box 2. While inter-dependencies between these different items (*e.g.* between enterprise losses and state subsidies) mean that they cannot simply be added together, their overall impact would appear to bring the total public sector deficit to over 12 per cent of GDP.

The 1997 Budget

Confronted with this loss of monetary and fiscal discipline, the new government elected in November 1996 faced the urgent task of implementing a credible stabilisation programme. As noted in the introduction to this chapter, the government has also sought to tackle the root cause of the persistent macroeconomic difficulties by pursuing extensive and long overdue structural reforms. The international lenders, notably the International Monetary Fund and World Bank,[12]

Box 2. **Quasi-fiscal expenditures in 1996**

The main forms of quasi-fiscal spending in 1996 were the following:

- Directed lending financed by the NBR rose sharply in 1996, especially in the second half of the year. In total, NBR refinancing expanded by over 3 700 billion lei (3.4 per cent of GDP) in the year to December 1996. The bulk of this increase comprised various forms of structural and other directed credits (''credits with derogation'') (Figure 11). Around half of these NBR credits involved directed lending to the agricultural sector, especially the refinancing of loans provided through the state-owned Banca Agricola. The other half comprised support for industry (especially the energy-intensive sectors), and credits provided to support two banks in difficulty (see later in this chapter) and to other domestic banks to finance their purchases of government debt.
- Moreover, these credits were provided under concessionary interest rates – for example, at the discount rate (35 per cent) for structural credits and at zero interest with credits to troubled banks, whereas the commercial lending rate for non-bank customers was around 55 per cent throughout the year. Rough estimates suggest that the interest ''subsidy'' in these NBR credits was equivalent to at least 1 per cent of GDP (which comes in addition to interest subsidies included in the budget).
- As discussed in more detail in chapter III, enterprise losses and payment arrears continued to rise in 1996, especially among the large state-owned companies. For example, the largest 222 companies with majority state capital collectively had losses of 2.3 trillion (2 per cent of GDP) over the first three-quarters of the year, more than half of these losses occurring in 25 *Régies Autonomes* (RAs). Total gross arrears in the economy (mainly among state-controlled companies) increased from 12 trillion lei at end-1995 to 39.5 trillion lei (36 per cent of GDP) at end-1996, of which 7.8 trillion lei represented arrears of the RAs. About one-third of the total arrears were arrears to the budget (including the social security funds) and so have their counterpart in accumulated shortfalls in government revenue. For example, tax arrears in the RAs listed in Table 15 were around 2 per cent of GDP at end-1996, of which 75 per cent come from RENEL, Romgaz and SNCFR. Much of the remainder consists of arrears between public enterprises (*e.g.* from RENEL to Romgaz) and would largely ''net out'' in a consolidation exercise. However, an important residual of possibly 2 to 3 per cent of GDP – including overdue wage payments, and debts to banks and non-state suppliers – represents a further potential charge on the public finances (and should be reflected as an additional deterioration in the fiscal position).*

* For the 13 RAs in Table 15, overdue payments (including wages) to non-state creditors equal around 1 per cent of GDP, suggesting that the total over all state companies could be 2 to 3 per cent of GDP.

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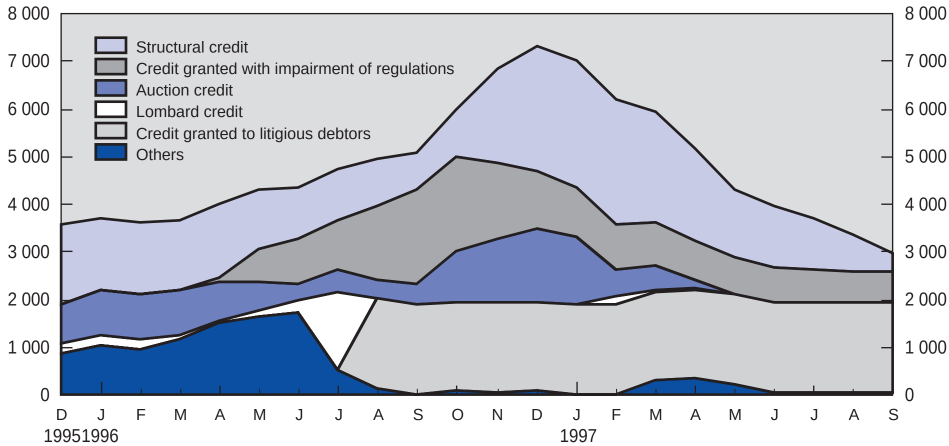
- Various trading restrictions and other measures were used to support the exchange rate in 1996 (see below) creating an implicit tax on exports and subsidy on imports. This policy was directed in particular at lowering the price of energy imports. An indication of the size of this quasi-fiscal support can be seen in the growing divergence during the year between the ''official'' exchange rate and the more market-orientated rate in foreign exchange bureaux (see Figure 15 below) – the premium in the latter averaged 16 per cent in 1996, and reaching 33 per cent in November. While the overall impact of this measure is difficult to measure (for example, an unofficial foreign exchange market arose between enterprises to get around official restrictions), the subsidy value applied to just one-third of goods' imports (roughly the share taken up by energy and chemical products) would be equivalent to at least 0.5 per cent of GDP.

have worked closely with the Romanian government on the stabilisation and reform programme, providing expertise and financial support for the ''renewed'' transition that is now underway.

The planned 1997 cash deficit rose to 4.5 per cent of GDP, compared with the 3.9 per cent ''official'' deficit of 1996. On an accruals basis, however, the deficit is projected to fall to 3.5 per cent of GDP in 1997, down from 5.8 per cent in 1996. Moreover, all forms of quasi-fiscal spending were eliminated from the 1997 budget, with support for agriculture, industry and other economic activities brought fully ''on budget''. Taken together, these measures imply that a very sizeable fiscal contraction – potentially on the order of 8 percentage points of GDP – is in train. In the original programme, the 1997 deficit arose only in the state budget: all of the social budgets and other extra-budgetary funds, including notably the unemployment fund, were projected to be in balance or surplus. As noted below, however, shortfalls in the social insurance budget subsequently led to transfers of 0.5 per cent of GDP from the state budget to that fund (Statistical Annex Table A11).

A substantial shortfall of tax revenues forced a major mid-year review of the 1997 budget. The targeted cash deficit of 4.5 per cent of GDP was preserved, but total revenue and spending projections were slashed by nearly 4 per cent of GDP (Table 7). Problems of revenue collection have arisen mainly in the area of

Figure 11. **NBR REFINANCING**
Billion of lei, daily average



Source: National Bank of Romania.

personal taxes on labour income, including social security charges; in the revised budget, these are now projected to be 2.4 percentage points lower as a share of GDP than in 1996 and in the original programme for 1997. This tax shortfall reflects the significant decline in earnings in the economy: it has occurred against the backdrop of generally stable unemployment (at least up to August), and higher-than-projected nominal activity (the initial end-year inflation projection of 90 per cent had already been exceeded in the period December 1996-June 1997). The authorities have also expressed concern about ongoing delays in remittances from enterprises to the state budget and social insurance fund. These problems apparently persist, even though the government has made clear its intentions to take a firmer line regarding revenue collection, particularly regarding the avoidance of any build-up of enterprise arrears (as occurred in 1996), and accelerated repayment of past arrears. For example, the fiscal authorities have second claim on the revenue stream of state enterprises, ranking behind the payment of wages but ahead of payments for energy and supplies. Despite reductions in some of the

Table 7. **General government consolidated revenue and expenditure**[1]

As per cent share in GDP

	1993	1994	1995	1996	1997 Budget	1997 Rectified budget
Total revenue	33.9	32.1	31.9	29.7	30.8	27.0
Current revenue	33.6	31.9	31.8	29.5	30.5	26.7
Tax revenue	31.3	28.2	28.7	26.7	28.4	24.1
Excise, VAT, oil tax	7.3	6.1	6.7	6.2	7.5	6.2
Wage tax	6.6	6.5	6.3	6.1	5.6	4.7
Profit tax	3.8	3.8	3.9	3.2	3.2	3.4
Custom taxes	1.3	1.1	1.4	1.5	2.1	1.3
Social security	10.7	9.2	7.9	7.4	7.9	6.4
Other taxes	1.6	1.4	2.5	2.1	2.1	2.0
Non-tax revenue	2.3	3.7	3.2	2.9	2.0	2.6
Capital revenue	0.2	0.1	0.1	0.1	0.3	0.3
Total expenditure	34.2	33.9	34.8	33.6	35.3	31.5
Current	29.1	28.1	28.8	29.2	30.5	27.4
Goods and services	12.0	12.4	12.5	12.2	10.8	9.9
Wages	6.8	6.7	6.5	6.0	5.1	4.8
Other	5.2	5.6	6.0	6.1	5.8	5.1
Interest payments[2]	0.8	1.3	1.3	1.6	4.2	3.6
Subsidies and transfers	16.3	14.4	15.0	15.4	15.4	13.7
Subsidies	6.8	3.8	4.1	3.2	3.6	2.4
Transfers	9.5	10.5	10.9	11.1	12.7	11.3
Reserve fund					0.1	0.4
Capital	4.3	5.5	5.2	5.3	4.0	3.4
Lending minus repayments	0.5	0.2	0.6	0.4	0.9	0.6
Balance	–0.4	–1.9	–2.9	–4.0	–4.5	–4.5
Memorandum item:						
GDP (billion lei)	20 036	49 773	72 560	109 515	231 630	269 709

1. According to the official denomination of the public budget.
2. Interest payment for the public debt only.

Source: Ministry of Finance.

exemptions on VAT and customs duties, revenues from these sources are also projected to be lower than in 1996 and the initial 1997 programme.

On the expenditure side, the 3.8 percentage point reduction in spending (as a share of GDP) compared with the initial programme for 1997 was largely accomplished through only partial accommodation of the higher-than-expected inflation (which led to a 16 per cent rise in projected nominal GDP between the original and revised budget plans). There were also further nominal reduction in spending for some ministries, notably defence and agriculture and forestry.

Between 1996 and 1997, however, there have been several important changes in the spending structure (Table 8). These include:

- a substantial rise in social protection spending: the most significant item here is a large increase in child allowances (from 0.6 per cent of GDP in 1996 to 1.5 per cent in the revised 1997 budget). Smaller spending increases occurred in other areas, including targeted bread subsidies (to partially offset the effect of price liberalisation), spending on social canteens, and farmers' pensions;
- halving the spending share of agriculture, forestry and industry (from 4.6 to 2.3 per cent of GDP), in addition to the elimination of the directed credits and other forms of quasi-fiscal finance that were rampant in 1996. The reduction in agricultural subsidies is partly offset by on-budget provi-

Table 8. **General government consolidated expenditure**

As per cent share in GDP

	1995	1996	1997 Budget	1997 Rectified budget
Total expenditure	34.8	33.6	35.3	31.5
Public authorities	1.8	1.1	1.1	1.1
Defense	2.1	1.9	2.2	1.6
Public order and national safety	1.5	1.5	1.2	1.0
Education	3.4	3.5	3.7	3.5
Health	2.9	2.8	2.7	2.8
Culture, religion, sport, youth	0.5	0.5	0.6	0.5
Social welfare, children allowances, pensions	9.3	8.8	10.7	9.4
Other social expenditures	0.0	0.3	0.3	0.3
Community amenity affairs, housing	2.0	1.9	1.3	1.0
Environment and water	0.0	0.2	0.1	0.1
Industry	2.4	2.2	1.1	1.0
Agriculture, forestry	2.3	2.4	1.8	1.4
Transportation, communication	2.4	2.2	2.0	2.1
Other economic affairs and services	1.2	1.5	0.6	0.8
Research	0.0	0.4	0.3	0.3
Other expenditure	1.5	0.5	0.5	0.4
Transfers	0.0	0.0	0.0	0.0
Interest payments on public debt	1.3	1.6	4.2	3.6
Reserve fund	0.0	0.0	0.1	0.1
Lending	0.0	0.3	0.6	0.6
GDP (billion lei)	72 560	109 515	231 630	269 709

Source: Ministry of Finance.

sion of 0.4 per cent of GDP in new lending to agriculture, targeted on small land-holders (see Annex II);

– an increase of two percentage points of GDP in interest payments on public debt, given both the increase in the level of debt and its financing at market interest rates (in contrast with 1996).

The effects of these spending changes can also be seen from a functional perspective (Table 7). In particular, public sector wage costs are projected to fall by nearly 1.2 percentage point of GDP in 1997 compared with 1996, continuing the trend of recent years (this issue is discussed in more detail below). The decline occurs both through a 10 per cent reduction in staff in public administration,[13] and through partial indexation of salaries (in which salaries are adjusted by only 75 per cent of expected inflation). There is also a large reduction in public investment spending of 1.8 points of GDP, especially on equipment.

Fiscal pressures and areas requiring policy attention

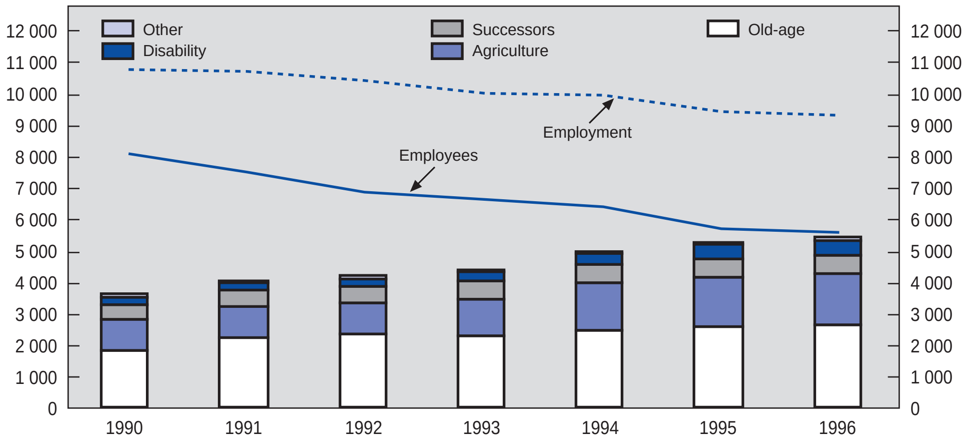
Social security funds

As noted above, the main social security budget ended 1996 with a deficit of 200 billion lei, despite receiving a special transfer of 312 billion lei (0.3 per cent of GDP). Difficulties in this area appear likely to persist. In the 1997 budget plan, a surplus of just over 100 billion lei was originally projected for this fund; after four months, however the deficit already totalled 710 billion lei, and further transfers (0.5 per cent of GDP) from the state budget to the insurance fund have been announced. The immediate reason for this shortfall is slower-than-expected growth in average earnings and hence in total labour income, leading to revenues from social security contributions falling 20 per cent short of their projected level.

In addition, however, there are deeper structural problems facing the social security system as a whole, which have important implications for its financial health over the longer term. As shown in Figure 12, there were over 5.4 million pension beneficiaries on average in 1996, including 2.7 million old-age pensioners, 0.5 million on disability pensions and 1.6 million recipients of agricultural pensions. The number of old-age and agricultural pensioners has increased by 49 per cent since 1990, while disability pension recipients have grown by 125 per cent. As in other transition economies, Romania broadened access to retirement

Figure 12. **SOCIAL SECURITY BENEFICIARIES**

Thousands



Source: Ministry of Finance.

allowances and other social benefits as a means of cushioning the adjustment shock (see chapter IV for further details).

While total employment was around 9.4 million at end-1996, this included 3.6 million self-employed (mainly in agriculture) who have not been required to pay social security contribution. The ratio of total pensioners to employees contributing to the social security system has therefore increased to nearly unity, compared with 0.44 in 1990 (Figure 12). The measures noted above have significantly increased eligibility for pensions and reduced the contribution base. It should also be noted, however, that the pensioner total includes 1.6 million recipients of agricultural pensions; these payments are very low (averaging 16 500 lei per month in 1996 compared with the standard old-age pension of 142 000 lei), and are funded mainly by transfers from the state budget. In 1992, the government decided that payments to a new agricultural pension scheme would not be compulsory, and only 60 000 employees contributed. These participants will be entitled to improved future pension benefits. Compulsory contributions for employees of agricultural enterprises (but not for individual farmers) have been reintroduced and overall pension levels increased in 1997 – as reflected in the projected growth in the agricultural pension fund in 1997, and a decline in the share of total revenues coming from state subsidies. Implementation of the contributions requirement appears to have been slow, however: in the first four months, contributions from economic agents provided only 22 per cent of fund revenues (the rest provided mainly by the state), against a full-year projection of 41 per cent.

In addition to these changes in the agriculture pension system, reforms to the main old-age pension scheme are important if current arrangements are to be sustained without the need for large transfers from the state budget. The government is currently investigating the options for reform, and these are discussed further in chapter IV. In general, the most pressing need for reform would appear to be in respect of *eligibility* criteria for disability and early retirement benefits. Levels of *entitlement*, however, appear moderate and even low, at least by OECD standards[14] – averaging 44 per cent of net wages for old-age pensions (at end-1996), 31 per cent for disability pensions, and under 10 per cent for agricultural pensions.

In contrast with the pension funds, the unemployment fund appears to be in significantly better shape. This fund had a surplus of 1 per cent of GDP in 1996. A lower surplus of just under 800 billion lei (0.3 per cent of GDP) is projected for 1997 and, in the first four months of the year, the surplus had already reached over 500 billion lei. The 1997 projections are based on a monthly average of 700 000 claimants of unemployment benefit, a rise of 57 per cent from the end-1996 level. The unemployment fund budget is ''helped'' by the fact that around 30 per cent of the current registered unemployed are not entitled to receive (or, for other reasons, do not claim) unemployment insurance or assistance benefits (see chapter IV). This proportion has been rising over time: it was just over 20 per cent in early-1996, and 13 per cent in early-1995. The 1997 budget for this fund also includes 1 049 billion lei to meet severance payments (discussed further in chapter IV). Provision of severance payments on rather generous terms could represent an area of fiscal pressure in 1998 and beyond, given the extent of restructuring still required in state-owned enterprises.

Tax simplification and base broadening

The revenue structure at the consolidated general government level is shown in Tables 7 and 9 (the latter table showing standardised data comparing Romania with Bulgaria, the Czech Republic and Poland). In broad terms, direct taxes on labour (from wage and social security taxes) account for just under half (46 per cent) of current revenues in Romania, indirect taxes (mainly VAT and customs duties) provide 30 per cent, and profit taxes contribute 11 per cent. While clearly not an outlier, Romania tends to put somewhat less emphasis on indirect taxes and to collect a greater share of revenues through profit taxes than the other countries shown.

The VAT regime appears to be rather inefficient. The standard rate of VAT is 18 per cent, and a rate of 9 per cent is applied to food and other consumer necessities (with exports zero rated). However, in total, VAT proceeds comprise only 6 per cent of final consumption expenditures. Among the many exemptions

Table 9. **Comparative structure of general government revenue, 1995**

In per cent

	Romania	Bulgaria	Czech Republic	Poland
Total revenue	**100.0**	100.0	100.0	100.0
Tax on income, profits, capital gains	**28.9**	16.7	14.8	27.6
Individual	**15.8**	5.8	1.7	20.0
Corporate	**13.1**	10.9	13.0	7.5
Social security contributions	**27.2**	21.2	40.2	25.1
Employees	**3.2**	0.0	11.3	0.0
Employers	**23.9**	18.6	29.0	25.1
Other	**0.0**	2.6	0.0	0.0
Taxes on payroll and work force	**0.0**	3.0	0.0	0.6
Taxes on property	**0.0**	0.2	0.7	0.0
Domestic taxes on goods and services	**23.5**	27.6	31.9	28.2
Taxes-international trade, transactions	**5.6**	8.1	3.6	7.7
Other taxes	**3.3**	0.3	0.6	0.3
Non-tax revenue	**11.5**	22.1	8.2	10.4
Capital revenue	**0.0**	0.6	0.0	0.2
Grants	**0.0**	0.3	0.0	0.0

Source: Government Financial Statistics, IMF.

from VAT are public utilities (including electricity, thermal energy and gas); services provided by financial institutions (banks, exchange offices, securities and insurance houses); publishing, printing and selling of newspapers, books and magazines; and imported goods that are exempt from customs duties or that come under the special tax provisions applied to foreign direct investment (see below). Broadening the base of the VAT by reducing the range of exemptions – such as that on utilities – could provide a source of additional revenues to compensate for losses arising through rate reductions and other rationalisations in the tax regime. Applying VAT on energy is also a mechanism for making end-users recognise more of the full cost of such resources, while distributional concerns may be better handled through the broader social support system (see chapter IV).

In addition to the difficulties with the VAT regime, a wide range of exemptions, reductions, and special provisions apply to other tax instruments in Romania. These features significantly complicate the tax system, reducing its transparency and revenue-gathering potential. For example, with investment (and associated depreciation) expenses there appears to be one set of tax provisions for large foreign investments, another for large domestic enterprises and still another for small entrepreneurs (see below). As discussed in more detail in chapter III, an emergency ordinance regarding foreign investment was introduced in mid-1997; this ordinance provides for reductions (including exemptions) in customs duties and rates of profit tax, in some cases for five years or even more. Such special provisions generally stem from possibly well-intended objectives of providing incentives for foreign direct investment, sectoral development (*e.g.* for exploration and exploitation of oil and gas resources) and export orientated activities. However, it is not clear that tax policy is an effective instrument for reaching such goals (whether in Romania or elsewhere). The result, instead, is a tax system that is complex to understand and administer, generating substantial scope for tax avoidance and evasion. Moreover, risks of corruption are likely to rise when case-by-case and subjective determinations of tax liabilities play an important role. Customs posts are widely perceived as being problematic in these respects, not surprisingly given the range of special tax provisions administered at border crossings and the slow pace at which information technology has been introduced.[15]

Depreciation provisions

Depreciation provisions that were in force until August 1997 suffered from a number of deficiencies, which combined to overstate taxable profits. Asset lives for tax purposes tended to be overstated, with assets assigned to excessively long-lived categories and depreciation based on the extent of *utilisation* of the items concerned. Accelerated depreciation was allowed only with the approval of the Ministry of Finance. Furthermore, depreciation expenses could not be adjusted to take inflation into account. Several of these deficiencies have now been corrected in new depreciation regulations (Ordinance 54, August 1997). Depreciation periods are now shorter and accelerated depreciation does not require Ministry of Finance approval. However, inflation adjustment is still not allowed.

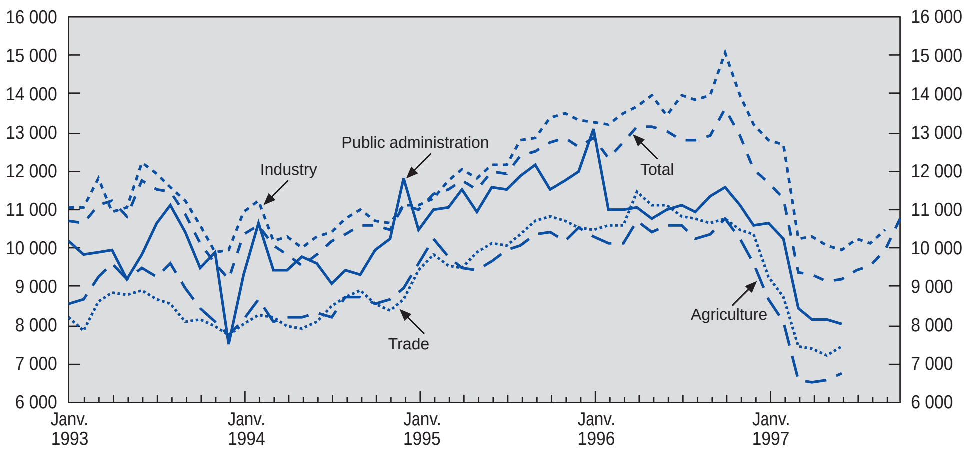
In addition, generous provisions apply to the deductibility of investment expenditures by entrepreneurs (*i.e.* usually in the small business sector): reinvested profit enjoys tax reductions. These provisions have led predictably to a high level of investment and low taxable profits in the entrepreneurial sector. While appropriate investment expenditures are clearly not to be discouraged, over-investment is costly both from a fiscal and broader economic perspective. A tighter definition of investments may be needed, coupled with improvements in the depreciation law (as noted above) to ensure more uniform treatment of investment expensing in different parts of the business sector.

Public sector wages

Wage levels in public administration are currently 13 per cent below average wages in the economy. Real wages in this sector fell by 44 per cent between October 1990 and 1996, compared with a 29 per cent decline in the economy as whole (Figure 13). The share of general government wages has declined from 6.8 per cent to 4.8 per cent of GDP between 1993 and 1997, and from 20 to 15 per cent of general government spending (Table 7). While this situation reflects and contributes to the process of fiscal restraint, there is also a risk – already apparent in some cases – of government departments finding it increasingly difficult to attract and retain skilled personnel. Similarly, there are concerns that the quality of education, health and other public services may suffer if skilled and experienced staff are lost. In general, the ‘‘solution’’ to these difficulties does not have to involve large pay increases across the public sector, particularly as such an approach would tend to be very costly for public budgets.

Figure 13. **REAL WAGE**

Seasonally adjusted net monthly wages, deflated by CPI, in lei at prices of January 1992



Source: National Commission for Statistics.

What could be more manageable (from both a fiscal and personnel management perspective) could be to give departments and other public agencies greater autonomy in wage negotiations, *within firm budgetary ceilings;* in this case, departments would be able to pay more if necessary to skilled staff, while having to fund these pay decisions from elsewhere in their budgets.

Fiscal pressures coming from the banking sector

As discussed in more detail later in this chapter, the poor state of some parts of the banking sector could also lead to additional pressures on public deficit and debt levels. Pressure could come from at least three sources: from the restructuring of large state-owned banks prior to privatisation, requiring their recapitalisation and the taking-over by the state of some or all of their bad debt portfolio; from additional bank difficulties – and subsequent state intervention – arising in the current austerity programme, as enterprises find they can no longer draw on state subsides and subsidised foreign exchange to meet their financial obligations; and, in the case of further loan defaults, from banks calling on state guarantees given when loans were originally granted. It is noteworthy in this context that the restructuring programme of Banca Agricola, as announced by the Finance Minister in September, involves its 3 500 billion lei deficit being taken over by the state and covered by a special issue of treasury bills. There are also indications that the same approach is likely to be used in the case of Bancorex.

Monetary policy: recent developments and current challenges

In recent years, monetary policy has been overburdened as a result of lack of coherence and consistency in overall economic policy-making. A major feature of economic policy during 1992-1996 was the relative neglect of key trade-offs (for example, economic growth vs. external balance) and of the role of privatisation for bringing about capital inflows (and thereby enhancing restructuring). The current programme of reforms represents a significant improvement in these respects, and is clearly much better placed to support the disinflation objectives of monetary policy. Nevertheless – as discussed earlier in the context of fiscal policy and below for monetary policy – there is still scope for improvements in policy co-ordination and implementation. Such measures would improve the probability that sound, sustainable policies are put in place, and hence assist in building up the reputation and credibility of key institutions, including the NBR.

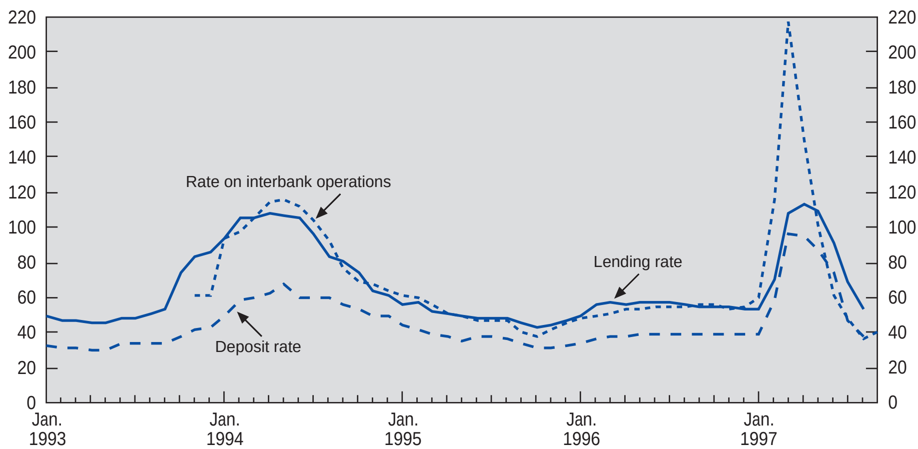
Monetary policy and unsustainable growth: 1993-1996

As described in detail in the previous Economic Assessment of Romania (OECD, 1993) the period 1990-1993 was one of very high inflation and unsound, inconsistent policies. The spectre of hyperinflation and the persistence of a large, unsustainable trade imbalance forced policy-makers to reconsider the policy mix in the last quarter of 1993.

The main decision was the dramatic rise in nominal interest rates. Thus, the National Bank's average refinancing interest rate rose from an annual rate of 59.1 per cent in September 1993 to 136.3 per cent in January 1994 (staying at that high level for another three months) and, with a two-month lag, commercial banks' lending rates also rose sharply (Figure 14). This measure stemmed the flight from leu[16] and helped the formation of an active foreign exchange market, providing support for foreign trade growth.

Figure 14. **COMMERCIAL BANKS' INTEREST RATES**

Per cent per annum



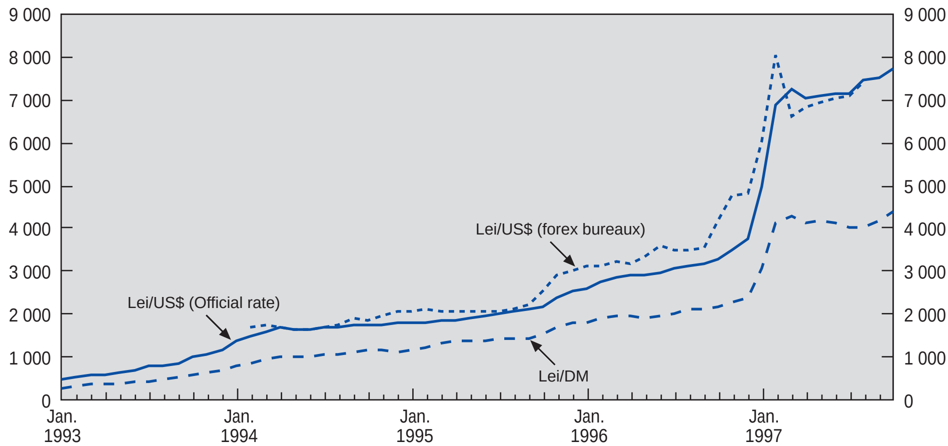
Source: National Bank of Romania.

Another key decision was the substantial devaluation (in several stages) of the official (inter-bank market) exchange rate, which aligned it with the rate prevailing on the grey market (Figure 15). This reduced costs of entry for those needing foreign exchange, while leaving room for possible efficiency gains.[17]

The third measure of the policy package consisted of stricter control of base money. And, finally, the budget deficit was lowered (when corrected by the removal of explicit and implicit subsidies).[18] All these measures were complemented by general wage restraint.

Following these policy measures, inflation came down to 61.7 per cent (December on December) in 1994 (from 296 per cent at end-1993); real GDP grew by 3.9 per cent; and an impressive reduction of the trade deficit was achieved (to US$411 million compared with US$1 128 million in 1993). Contributing factors were also the growth in the world economy (including recovery from recession in Western and Central Europe), and the US$ depreciation (reducing the price of imported oil). The economy appeared to absorb the real ‘‘interest

Figure 15. **NOMINAL EXCHANGE RATE**



Source: National Bank of Romania, OECD.

rate shock'' surprisingly well: aggregate arrears (including inter-enterprise debt) were 23 per cent of GDP at the end of 1994, comparable to the figure for 1993; the share of inventories in GDP was also stable ; and gross investment rose markedly.

The estimated real growth rate in 1995 rose further, to a 7.1 per cent high, while inflation fell to 27.8 per cent by year-end. The remonetisation of the economy continued (Table 10): the money supply expanded faster than inflation (M2, which includes hard currency deposits, was up 71 per cent from December 1994 to December 1995), while money velocity fell from over 7.5 in 1993 to below 5 in 1995.

Underlying these developments, however, the slow pace of structural adjustment meant that imports increased rapidly, jumping by more than 30 per cent, while exports increased by around 20 per cent. As a result, the trade deficit increased again, to more than US$1 200 million, and put pressure on the interbank foreign exchange market.

Table 10. **Remonetisation**

Per cent change over previous year

	1994	1995	1996
Money supply, M2	138.1	71	66
Inflation, CPI	61.7	27.8	56.9

Source: National Bank of Romania.

The renewed sharp rise in the trade (and current account) deficit should have caused concern since Romania relies extensively on compensatory external financing. In view of the small level of foreign reserves, relatively small shortfalls of accommodating flows can therefore trigger losses of net foreign assets and provoke confidence crises. Indeed, a confidence crisis manifested itself in the last quarter of 1995, after the foreign exchange reserves of the banking system had been falling for several months.

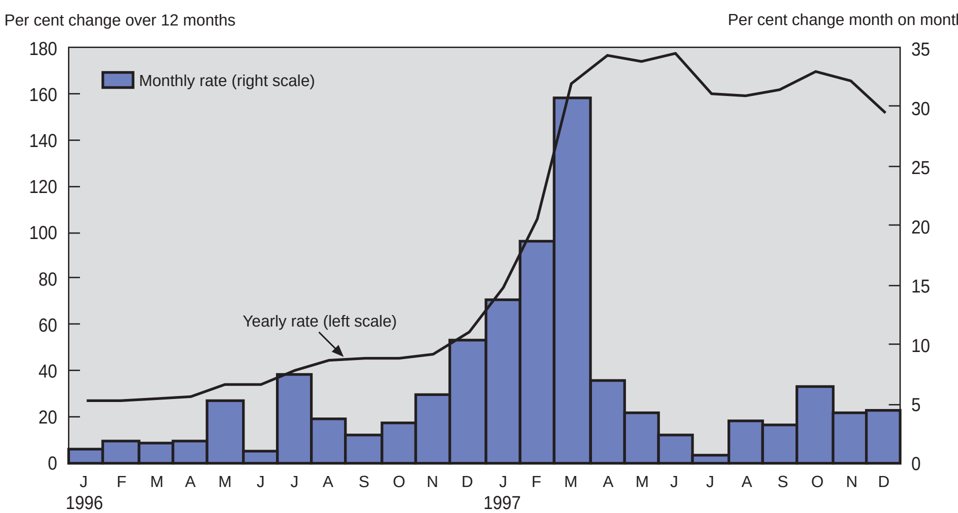
An explanation of the rapid deterioration of the trade imbalance is complicated, considering that the real exchange rate did not appreciate in 1995 (though it did so in the second half of 1994), and that major terms of trade changes did not take place in that period. However, a plausible underlying cause can be found in the relaxation of monetary policy in the second half of 1994, continuing into the following year: this enhanced a domestic demand-driven economic upswing in an environment undergoing insufficient restructuring. The expansion of hard currency credits at lower real rates than leu loans also stimulated import growth, improving the price competitiveness of imported goods vis-à-vis domestic output.

Although signs of unsustainable growth were clearly apparent in the first half of 1995, policy-makers were slow to react and underestimated the trade-offs between the various targets of macroeconomic policy. These policy failures set the stage for the loss of macroeconomic control in the following year.

The linkages between the dynamics of inflation and the way the budget deficit is financed became evident in 1996. As described earlier in this chapter, the initially programmed budget deficit of 2.2 per cent of GDP turned out to be 5.8 per cent (on an accrual basis), and much higher when quasi-fiscal items are included. Inflationary financing occurred via the refinancing of commercial banks, which bought increasing quantities of three-month Treasury bills. In addition, base money increased to accommodate the quasi-fiscal deficit, including the losses of agriculture and of the *Régies Autonomes*.

The trade and current account deficits also widened in 1996 (the latter reaching approximately 7.2 per cent of GDP), even though GDP growth fell to 4.1 per cent. With the budget deficit and its inflationary financing growing at a faster rate in the second half of the year,[19] inflation rebounded: the monthly inflation rate was over 10 per cent in December 1996, and 56.9 per cent against December 1995 (Figure 16). In the last quarter of 1996, money velocity was levelling-off, indicating that the period of remonetisation was coming to a close. The accommodative stance of monetary policy in the second half of the year is shown by the average monthly rate of expansion of the money supply, which was 6 per cent in that period as against 2.7 per cent in the first half. Very troublesome also were the higher distortions in relative prices due, especially, to the delay in adjusting energy prices and the administrative control of the exchange rate. Overall, the macroeconomic stabilisation programme was in a complete disarray.

Figure 16. **RECENT CPI TRENDS**



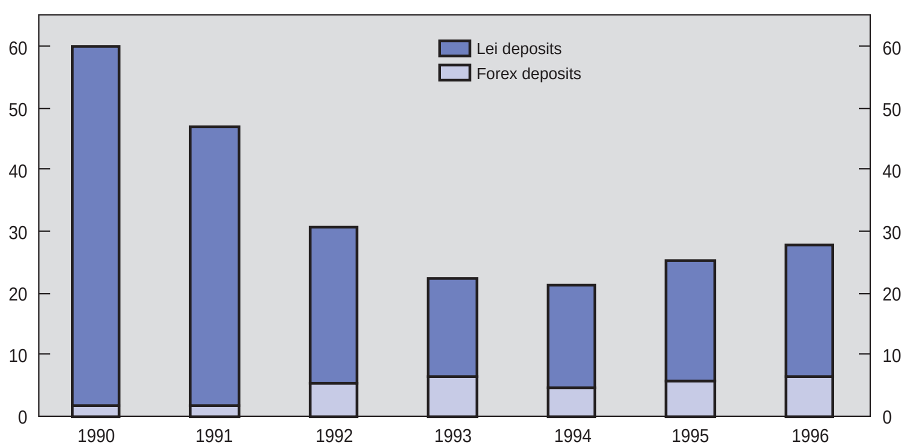
Source: National Commission for Statistics.

Aspects of remonetisation 1994-1996

From 1994 to the first half of 1996, remonetisation of the economy is indicated by the faster expansion of the money supply than the inflation rate (Table 10), and growth in the ratio of money to GDP (Figure 17). This process supported certain elements of the economic recovery during this period, but also contributed to the short-lived nature of the GDP growth and disinflation that occurred. It is important to single out these unsustainable aspects of remonetisation.

First, this process facilitated the subsidisation of various sectors of the economy (especially agriculture and the energy sector) from NBR resources, at a time when the Bank was supposed to be pursuing the reduction of inflation. This sectoral financing mirrored the existence of major structural disequilibria in the economy. The size of these disequilibria and their dynamic are illustrated by the structure of the banks' refinancing by the NBR; most of it is made up of directed credit, whose share in the whole refinancing was above 50 per cent during 1996 (Statistical Annex Table A10). Out of total refinancing, credit to agriculture

Figure 17. **THE RATIO OF MONEY SUPPLY TO GDP**
Percentage of nominal GDP



Source: National Bank of Romania.

accounted for about 50 per cent. This tendency ran counter to the stated intention of raising the share of auction credit, and of having markets decide increasingly about credit allocation.

Secondly, remonetisation ‘‘helped’’ putting off tackling the two crippled banks – Dacia Felix and Credit Bank; a total of more than 1 700 billion lei had been injected in these banks by end-1996 through special credits.[20]

Thirdly, remonetisation took place, primarily, via base money injections which fuelled an unwarranted expansion of domestic credit. This type of remonetisation explains, *inter alia, i)* why the level of NBR’s refinancing remained extremely high as a percentage of base money; and *ii)* the deceptive character of the growth of foreign exchange reserves in 1996 (when Romania got back on to international capital markets), if one considers that, in the same year, the amount of net foreign assets went down considerably.

Finally, this remonetisation slowed down the development of monetary policy instruments, namely open market operations. This is because the NBR did not feel the pressure to cope with a surge of liquidity as in the case of substantial capital inflows. Why such inflows did not happen can be attributed largely to the weak pace of privatisation during 1994-1996, the poor functioning of capital markets during those years, and the policy credibility problem faced by decision-makers.

November 1996 and the new government’s policy

The major guidelines of the new government’s programme, with direct or indirect bearing on monetary policy, are the following:

– a drastic cut in base money and a tight control of liquidity;[21]
– the transfer of the quasi-fiscal deficit activities of the NBR to the state budget; this refers, in particular, to the renunciation by the Central Bank of lending at preferential rates to the Agricultural Bank as a means of subsidising agriculture;
– a sharp reduction of the overall consolidated budget deficit (taking into account the implicit subsidies and other quasi-fiscal items in 1996);

– the termination of rationing on the foreign exchange market (which involved the dramatic depreciation of the currency in a first stage of the process).

The implementation of these policies has been predicated on the assumption of improving financial discipline in the economy generally, including containing (or even reducing) the amount of arrears.

As already noted, the new economic programme's impact on macroeconomic policy settings is illustrated clearly by the large reductions both in the real money base (including refinancing from the National Bank), and in budget expenditures. Interest rates followed a pattern in line with the tight monetary policy: they jumped sharply in the first quarter and, in March and April, inter-bank rates hovered in the range of 200 per cent (see Figure 14). Subsequently, interest rates declined along with inflation – although remained high in real terms – but increased again late in the year as monetary policy was tightened to counter the upsurge in inflation (see Chapter I). The exchange rate depreciated severely in January and February, falling from around 4 000 to 9 000 lei to the US$ in this period; the leu then stabilised at around 7 000 lei/US$ by the end of the first quarter, declining slowly to 8 000 lei/US$ by November (see Figure 15).

Key issues currently facing monetary policy

There are a number of important pressures and concerns currently facing the monetary authorities (and economic policy-makers more generally). While closely related, these matters can be grouped roughly as follows:

– the role and impact of *capital flows;*
– the monetary policy stance regarding the *exchange rate;*
– developments in *credit conditions and interest rates;*
– *co-ordination and consistency* between monetary policy and other areas of reform, notably fiscal policy.

Capital flows

Capital inflows have increased sharply during 1997. This development can be attributed to several factors: the implementation, and rising credibility, of the stabilisation programme (which has led to high interest rates and relative

Box 3. **Programming further liberalisation of capital movements**

Romania does not have a law governing exchange restrictions and capital controls but a set of regulations issued by the authorities which constitute what is called the ''foreign exchange regime''. This regime has been significantly liberalised with respect to *capital inflows*.

There are no regulatory impediments to *foreign direct investment and the right of establishment* and to any subsequent transfers abroad by foreign investors (see section on FDI). A new ordinance issued by the government in June 1997 provides for clearer legal protection and commitment to National Treatment of foreign direct investment. This ordinance was approved by the Parliament on 4 July 1997 so that it became a law, in replacement of the 1991 Foreign Investment Law.

The ordinance also stipulates that non-residents can make *portfolio investments* into Romania. Portfolio investment is defined as a purchase of domestic securities, including government debt securities, on a recognised Romanian market, which may cover direct investment according to internationally accepted definitions.* In addition, the ordinance guarantees the right to transfer abroad, in foreign currency, profits and proceeds of the liquidation of portfolio investment. These provisions represent major progress in terms of market access and transparency, as under the former regime such right to transfer was not granted and the regulations were unclear as to whether the underlying transaction relating to a foreign portfolio investment was permitted or not.

Another provision of the ordinance stipulates that a tax of 1.5 per cent shall be charged on the value of domestic securities purchased by a foreign investor on a recognised securities market. This provision is aimed at penalising short-term foreign portfolio investments rather than long-term investments (the shorter the maturity of an investment, the higher the transaction cost relative to the return in the investment concerned).

Under Romanian foreign exchange regulations, almost all *capital outflows* by residents are subject to prior approval by the National Bank of Romania and/or the Ministry of Finance. This extensively restrictive regime remained unchanged since the beginning of the transition process for fear of capital flight in a context of macroeconomic instability and political uncertainty. Transactions subject to restrictions include in

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* For instance, equity participation by a foreign investor representing 10 per cent or more of the capital of the enterprise concerned is considered, for statistical purposes, a direct investment in the IMF Balance-of-Payments Manual and in the OECD Benchmark Definition for Foreign Direct Investment. Under the OECD Code of Liberalisation of Capital Movements, any single foreign equity participation for the purpose of establishing lasting economic relations with an enterprise, such as participations which give the possibility of exercising an effective influence on the management thereof, is considered a direct investment.

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particular outward direct investment by domestic enterprises and outward trade credits of one year or more. These are basic operations that have been liberalised at an early stage in other, more advanced central and eastern European countries. Such liberalisation *inter alia* facilitates the expansion of exports and business opportunities abroad of domestic enterprises as the economy is maturing.

exchange rate stability following the initial depreciation); the speeding-up of the privatisation process; beginning of operations on the over the counter market (RASDAQ) and the increasing number of companies listed at the Bucharest Stock Exchange (BSE);[22] and a favourable legislative environment, including a very liberal taxation regime for portfolio investment (see Box 3).

These inflows – combined with its exchange rate objectives (see below) – have allowed the NBR to build up its foreign exchange reserves. As a result, the Bank has been confronted with the need to sterilise a large quantity of excess liquidity. In part, base money injections have been counteracted by the reduction in refinancing (with net refinancing stopped at the beginning of 1997 and auction credits discontinued in April). Beyond these steps, the NBR's options have been limited. Prolonged open market operations were not possible, as the stock of Treasury bills held by the NBR was very low. Instead, the NBR had to resort to attracting deposits as the main tool for absorbing liquidity, and also had to raise reserve requirements for the commercial banks.

The intensity of capital inflows is indicated by the way they have changed the composition of the balance sheet of the National Bank. In December 1996, reserve money totalled 7.9 trillion lei, and was made up, on the asset side, of –1.7 trillion lei of net foreign assets (NFA) and 9.6 trillion lei of net domestic assets (NDA). At the end of June, 1997, the situation was dramatically changed: NFA had grown to 7.2 trillion lei, while NDA were only 282 billion lei (*cf.* Monetary Survey, Statistical Annex Table A10) . Together with the proceeds of the Eurobond issue of June (DM 600 million), the foreign reserves of the NBR (including gold) grew from around US$1.6 billion in December 1996 to US$3.6 billion by end-October 1997.

Capital inflows have altered substantively the monetisation of the economy. Whereas the refinancing of commercial banks by the NBR was over 100 per cent

Box 4. **Instruments of monetary policy**

Monetary policy has made increasing use of indirect tools in recent years: refinancing credits, NBR interest rates, and reserve requirements have replaced credit ceilings. However, a major feature of the conduct of monetary policy until end-1996 was the incongruence between the intention of using indirect instruments and the high share of directed credits in the total refinancing of the National Bank.

NBR's refinancing

The refinancing of commercial banks is the main tool for the control of the monetary base, which is the operational target of the NBR. Refinancing consists of four windows: directed credits, auction, Lombard (overdraft), and special credits which can be seen as a form of directed credits.

Until 1996 *directed credits* were the main tool for credit allocation, at preferential rates, to various sectors of the economy, to agriculture and the energy sector in particular. In that year, whereas the average bank lending rate was 56 per cent the average rate for directed credits was 37 per cent. At the end of 1996, these credits represented 54 per cent of the entire refinancing done by the NBR, the same as in 1995. Directed credit were undertaken, basically, through state-owned banks. During 1995 and 1996 more than 80 per cent of directed credits went to agriculture. At the start of 1997, directed credits were stopped.

In order to judge the actual size of directed credits one has to add *special credits*, which were granted by the NBR to banks in distress. Dacia Felix and Credit Bank, the two private banks which became insolvent in 1995, held a very sizeable portion of refinancing in the last two years – more than a quarter (see Figure 11). The combination of special credit and directed credit largely crowded out the use of *auction credit*. The latter should in principle be the main form of market-based allocation, and the stated policy intention of the NBR was that auction credit should be the prevalent form of refinancing by end-1996. Instead, auction credit represented only one quarter of total refinancing in 1996, significantly lower than its share in 1993 and 1994. A positive development was the requirement for banks to provide adequate collateral, which took the shape of T-bills in the absence of reliable private sector securities. In April 1997, auction credits were suspended.

The *Lombard* applies to credit of last resort and is at a penalty interest rate – the highest rate among the rates practised by the NBR. The Lombard has an overnight maturity. The experience of 1995, when the two failed banks resorted to this facility ''on a grand scale'', compelled the NBR to introduce special conditions of access: an upper limit of 75 per cent of bank's own funds and full collateralisation of credit.

In February 1997, the NBR initiated its first open market operations with Treasury bills. In June, the Bank started to collect deposits from the commercial banks as an instrument to sterilise excess liquidity.

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Reserve requirements

This instrument was introduced in March 1992. Against forex deposits, banks can hold their reserves either in lei or in hard currency. Reserve requirements were modified several times in recent years as a means to influence the level of liquidity. In July 1997, required reserves for lei deposits were increased to 10 per cent from 7.5 per cent. Required reserves are remunerated 15 per cent for lei, and 1.5 per cent for hard currency reserves.

Interest rates

The introduction of positive real interest rates in late 1993 played a key role in improving confidence in the domestic currency, as suggested by the rise over subsequent years of leu deposits in broad money (see Figure 17). However, the artificially low interest rates applied to the NBR's directed credits contributed to the undermining of economic stabilisation and confidence in 1996.

Overall, until the end of 1996, the role of interest rates in allocating resources remained modest. This is indicated, for example, by the prevalence of directed credits in the total refinancing of the NBR. Another indicator is the ''mutual captivity'' between the large state-owned banks and their large clients; four such banks hold more than 70 per cent of bank lending. Aside from ''adverse selection'', these ties create a bias in lending, not necessarily to the more creditworthy customers. However, interest rates have begun playing a more active role in credit allocation in 1997.

The wide array of lending interest rates and the spreads among them mirror the segmentation of money markets; the increasing share of directed credits in total refinancing, as well as the faster expansion of the money supply than domestic credit, did maintain market segmentation and perpetuated implicit subsidies. The spreads practised by commercial banks have been quite high in recent years (around 20 per cent on average in 1996) (Figure 14) and reflect the desire to compensate the high volume of non-performing loans and the low yields obtained on the required reserves.*

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* The inclusion of the Savings Bank (CEC) overstates the average spread for commercial banks. This is because the CEC offers lower deposit rates for its benefits of a full government guarantee of savings. This edge of the CEC continues even after the introduction of the Deposit Insurance Scheme covering the other commercial banks in August 1996, which guarantees up to 20 million lei deposits held (each) at different banks.

of the money base in late 1996, this ratio reached around 35 per cent in August 1997. This change was influenced by the drastic curtailment of refinancing itself which, at the end of June, 1997, was less than half that of December, 1996 – 3 801 billion lei as against 8 024 billion lei. In real terms, refinancing dropped by almost three quarters. It is very likely that this trend will continue and provide a different nature to the remonetisation of the economy.

Exchange rate policy since January 1997

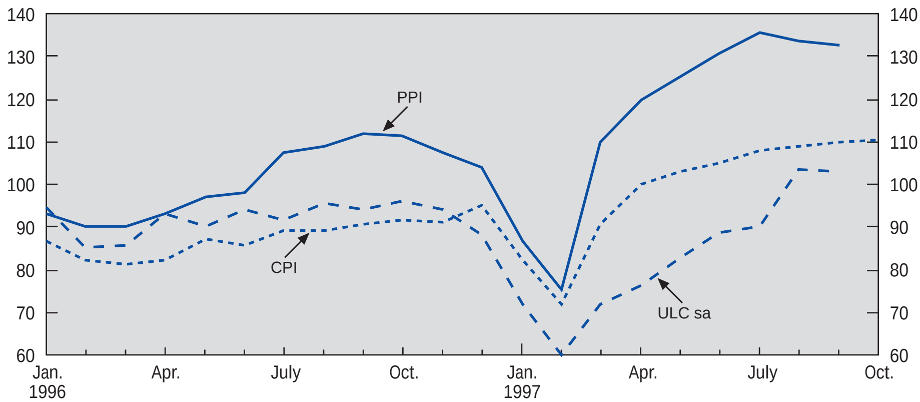
The major objective of the National Bank in 1997 is to disinflate the economy and lay the ground for durable macroeconomic stabilisation. To this end, the National Bank has been facing a dual challenge: it has sought to counteract the upward pressure put on the exchange rate by the heavy capital inflows; and, as noted above, it has had to control the liquidity impact of its intervention activities in order to continue bringing inflation down and to stabilise it at a low level.

The exchange rate regime of the NBR is a managed float. Administrative attempts to control the exchange rate – for example, by allowing only four state-owned banks to operate as official foreign exchange dealers – ended after the elections in 1996. As noted earlier, a period of volatility in the exchange rate earlier in 1997 has been followed by a steadier nominal depreciation. The extent of real appreciation that has occurred in 1997 should also be noted, particularly in terms of non-dollar-denominated trade. From January to July, 1997, the real appreciation (using the CPI) in terms of a trade-weighted currency basket (in which the Deutschemark has a 60 per cent weight) was 31 per cent (Figure 18). Against the DM, the real appreciation was 36 per cent on a CPI and unit labour cost basis, and 63 per cent using the PPI.

The monetary authorities currently confront vital questions regarding the appropriate stance of policy towards exchange rate pressures during the stabilisation process, including the extent to which further real (and even nominal) appreciation of the exchange rate should be accepted. The same questions have been faced by most of the countries in Central and Eastern Europe (and elsewhere) during their recent experiences with stabilisation and disinflation. However, few of these countries have had the degree of policy turmoil and reversal as experienced by Romania. This background, and the potential fragility of the current economic situation, highlight the importance of pursuing policies which will support the *sustainability* of stabilisation and adjustment in Romania.

On the one hand, accepting a faster rate of real exchange rate appreciation (through stability or appreciation in the nominal exchange rate) would increase disinflation pressure in the economy, and hence probably contribute to further

Figure 18. **REAL EFFECTIVE EXCHANGE RATE**[1]
1993 = 100



1. Effective exchange rate (weighted with currency basket: 60% DM and 40% US$). Growth in the index denotes appreciation of the lei and *vice versa*.

Source: National Bank of Romania, OECD.

declines in interest rates (at least in nominal terms). Given the extent of economic change, the level of the equilibrium real exchange rate is hard to gauge. However, in support of further real appreciation, one could cite the efficiency gains arising from the stabilisation and adjustment programme; the low level of local wages (which have declined even further in real terms in 1997); and the share of labour intensive commodities in Romania exports (see chapter III).

On the other hand, such a strategy could create problems for the stabilisation programme over the medium term. In particular, the authorities (especially in the NBR) are concerned about a potential ‘‘boom and bust’’ cycle that could be induced through excessive short-term appreciation of the real exchange rate. The concern in this regard is that a strong appreciation could be followed by a large and damaging depreciation, leading to a loss of foreign and domestic confidence in the economic adjustment programme and requiring a significant re-tightening of policy settings.

Such a scenario could arise, for example, if the resumption of economic growth were accompanied by a rapid deterioration in trade and current account balances. Deficits in these accounts would likely be driven mainly by rising domestic demand, but could be exacerbated by poor export performance – especially if efficiency gains and new sources of exports do not occur quickly enough to offset the effects of the real exchange rate appreciation.

Furthermore, a sharp exchange rate depreciation would create major difficulties for the companies which borrowed heavily on foreign markets or resorted to domestic credits in hard currency. For example, whereas hard currency credits were 17 per cent of total lending in domestic currency at the end of 1993, they jumped to 37 per cent at the end of 1996. Should the leu depreciate sharply, the companies which are not export oriented would suffer major losses; in their plight they would be accompanied by commercial banks, especially those that have granted excessive hard-currency credits (as noted below there has already been a large rise during 1997 in overdue hard-currency credits). Such a situation could trigger a systemic crisis in the banking sector.

With its current level of reserves, the NBR has relatively weak financial muscle for coping with strong downward pressures on the currency. Perhaps more significantly (especially given the policy set-backs of 1996), the Bank still has progress to make in establishing itself as a highly credible, independent institution, which is able to support the currency when required. Also noteworthy is the foreign exchange constraint under which Romania has been operating. Trade imbalances during the transition process so far have been largely financed by compensatory flows from the IMF, the World Bank and other international bodies (whereas the higher trade deficits (as a share of GDP) of some neighbouring countries have been financed essentially by autonomous capital inflows and large service balance surpluses).

Given these concerns, it would seem reasonable for the NBR to continue with some degree of foreign exchange market intervention to build up reserves and contain upward pressures on the exchange rate – ***provided*** this strategy does not compromise the objective of achieving further reductions in inflation. The scope for foreign exchange market intervention therefore depends in part on the support for disinflation coming from elsewhere in the economy, including wage developments and the fiscal position. For example further real appreciation may be hard to avoid if demand-side pressures on the economy grow strongly or if, for other reasons, progress with disinflation is slower than desired. In this regard, the NBR should make it unambiguously clear that its primary goal is indeed to achieve a low and stable rate of inflation. Support from further fiscal restraint would also help in lowering domestic interest rates, and hence contribute to reducing pressures of short-term portfolio inflows.

Credit conditions and interest rates

As already noted, the new macroeconomic stabilisation program has entailed a drastic cut of the money supply in real terms. However, the effective size of this cut, and its impact on credit conditions and economic activity, is somewhat difficult to assess. In particular, there are several factors which have affected the demand for and the supply of loanable funds: the growth of liquidity in the last quarter of 1996, which fuelled inflation and which, consequently, should be seen as excess liquidity; the campaign against corruption mounted by the new government and the climate following the failure of the two banks (Dacia Felix and Credit Bank) which altered the propensity of bankers to lend; the compression of economic activity in 1997 entailed by macroeconomic adjustment; and the reduced level of borrowing by companies following the rise in the cost of credit.

There are several ways to measure the degree of excess liquidity – which started to manifest itself in the second half of 1996 and burgeoned in the final quarter – and hence the effective real cut in the money supply during 1997. One option is to compare the average dynamic of the money supply in the first three quarters of 1996 and apply the same pace to its increase in the last quarter of the year. The adjusted measure can then be used as the base for measuring the growth of the money supply in the first half of 1997. By this approach, the drop of money supply, in real terms, is about 32 per cent.[23] Alternatively, one can look at the discrepancy between the actual growth of base money during 1996 and the programmed figure, using the latter to measure the ‘‘adjusted’’ money supply at end-1996. In this case, the real reduction in the money supply in the first half of 1997 is around 16 per cent.[24]

By both measures, the tightening of credit conditions in the economy has therefore been less than it appears *prima facie*. Nevertheless, unless it is accompanied by an improvement of financial discipline, the tightening that has taken place is liable to show up in an increase of inter-enterprise debt, and of arrears in general (including to the state budget). Indeed, the mid-year budget correction described earlier in this chapter indicates the extent of the problem with tax collection in the current circumstances. Greater financial discipline would also reduce the crowding-out effect exerted by the large state-owned companies (although the actual extent of crowding-out, at least for major private companies, is questionable).[25]

Interest rate developments also have an important effect on the financial situation of enterprises and their ability to restructure. Many companies in the private sector rely on bank finance, and are highly leveraged. The level of arrears is also high in many private and state-owned enterprises (see chapter III). In such situations, high and rising real interest rates can create severe difficulties. An important policy question therefore concerns the pace of descent of nominal interest rates and the resulting level of real rates. Clearly, interest rates should be expected to follow the dynamic of inflation and, over time, to come down to levels which do not impair the real economy. At the same time, there is bound to be a rise in the demand for loanable funds – including borrowing by companies – once interest rates attain more ‘‘reasonable’’ levels. The challenge for the monetary authorities is therefore to ensure that interest rate trends continue supporting disinflation and the stabilisation programme as a whole: too fast a decline in interest rates could easily reignite inflationary pressures and shatter confidence in the programme.

The authorities could also consider encouraging commercial banks to offer floating rate loans (*i.e.* where the real component is fixed and the nominal rate adjusts according to actual inflation). Banks currently appear to include a sizeable premium in interest rates to cover the risk of unexpectedly higher inflation. Floating rates can provide a means for this risk to be shared between lenders and borrowers: banks would be assured of an acceptable real return, while enterprises (and other borrowers) could benefit from a lower overall rate structure and the prospect of further declines as inflation comes down. It is noteworthy that a number of OECD countries have at times offered floating rate issues of government debt instruments, both to signal their commitment to achieving and maintaining lower inflation, and potentially to lower debt servicing costs (when official inflation projections are lower than those of financial markets).

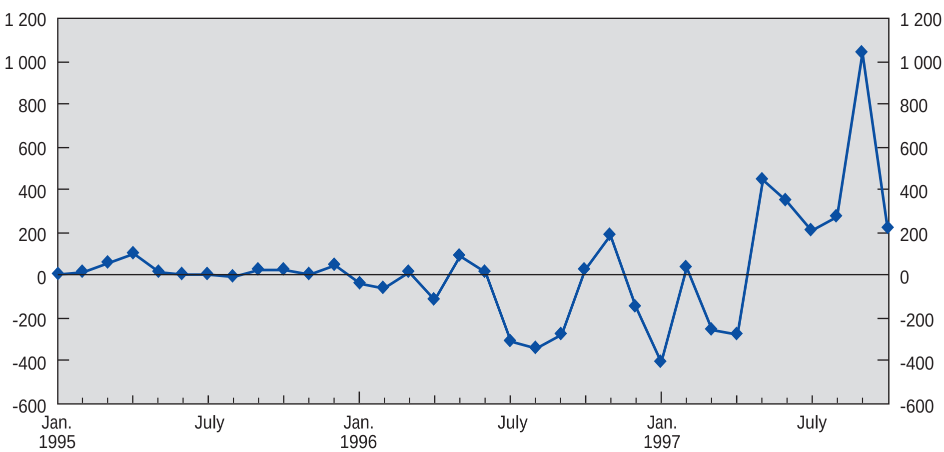
Policy co-ordination and consistency

There is scope for improving the transparency and effectiveness of monetary policy through better co-ordination with other parts of the public sector. For example, two areas of difficulty have arisen in the links with the treasury arm of the Ministry of Finance and the NBR. First, monetary policy has had to cope with the erratic pattern of operations (injections and absorptions) in the Treasury account at the central bank (Figure 19). The NBR acts as a residual in this respect, and needs to be constantly on the watch in order to compensate for undesired fluctuations in base money. In addition to poor co-ordination between the Ministry of Finance and the central bank (and difficulties faced by the former in predicting government sector cash flows), this situation is aggravated by the low level of monetisation of the economy and the large share of currency in circulation.

Second, monetary policy needs to be much better co-ordinated with the operations of the treasury so that interest rates, in general, move in tandem; sharp fluctuations or opposing signals – which confuse markets and disturb expectations – should be avoided. For example, the first one-year T-bill issue (which was quite sizeable, about 1 000 billion lei) of August 1997 carried a nominal yield of 60 per cent, which was at odds with the evolution of inflation in the economy and

Figure 19. **AVERAGE NET TREASURY ACCOUNT AT THE NBR**

Billions of lei



Source: National Bank of Romania.

the expected inflation for 1998. It is also puzzling that the 3-month T-bills, in circulation at that time, had yields in the range of 30-35 per cent per year.

Improved co-ordination is also needed at the level of policy design. For example, policy decisions surrounding the opening of the capital account, including the introduction of a liberal regime of taxation of portfolio investments, were apparently taken in some cases without full consultation with the NBR. Regardless of the merits of the decisions that were made, the fact that increased capital flows can have an important impact on monetary conditions suggests that the NBR, together with other key institutions affected by such decisions, should have been involved at an early stage of policy-making in this area.

A recurring theme in this survey is the need for consistency between macroeconomic and structural reforms. Nowhere is this more evident than in the relationship between monetary policy and the agricultural sector. The large and intermittent financing needs of agriculture, and the way these needs have been covered until recently, have constantly crippled monetary policy: the National Bank has been systematically under pressure to lend to the Agricultural Bank at preferential rates, which has meant that base money was injected in the system concomitantly with providing implicit subsidies. While these practices are no longer occurring, there is still a twofold challenge for economic policy: there is need to develop a viable non-inflationary mechanism for financing agriculture over the longer term; and a means of coping with a potential ''crowding-out'' effect has to be found, were agriculture to maintain a significant share of financing out of a limited pool of resources. Clearly, recent agricultural reform (see Annex II), including the renunciation of administered procurement prices, should improve the terms of trade for agriculture (reducing required subsidies) and the prospects of this sector.

The banking system

Various factors have hampered the development of the banking and financial sector in Romania. These include the limited stock of knowledge and experience in this area; inadequate structures of corporate governance; and misuse of policy instruments, often with political intrusion. These difficulties are reflected in the poor track record with macroeconomic stabilisation, undermined in part by the NBR's recurrent lapse into inflationary financing of the banking system. Inadequacies of the NBR's supervision function and authority are suggested by the mounting difficulties of several big state-owned banks, and the problems that surrounded the failure of two private banks.

The monetary and financial system of Romania is heavily dominated by banks. There are very thin financial markets, a scarcity of financial instruments available for investments, and a low volume of funds deposited by households and firms in non-bank financial institutions. There are several reasons for this state of affairs. It clearly takes time to develop financial institutions which enjoy the confidence of potential depositors; given this condition, a mutual funds' crisis in 1995 took a heavy toll.[26] Also important have been the weak pace of privatisation during 1992-1996, and the plethora of implicit subsidies which reduced the need of the government to finance its budget deficit transparently (and thereby, issue government paper which should be traded on secondary markets).

For most of the period since 1989, the refinancing of banks by the National Bank oscillated between 60 per cent and 100 per cent of base money; this means that commercial banks (domestic state owned banks) – themselves insufficiently capitalised – were largely unable to finance the needs of a hugely undercapitalised economy.

These difficulties in the banking sector have impaired the transmission channels of monetary policy, where the NBR has had to rely extensively on quantitative controls on banking activity. The transmission mechanism is also influenced by the lesser integration of Romanian financial markets with world markets; this has led to persistently high real interest rate differentials and hence skewed capital inflows. Furthermore, hard-currency deposits form part of broad money, and this currency duality makes the control of the supply of money via base money more tenuous. Currency in circulation accounts for a disproportionately large share, over 75 per cent, of base money and over 18 per cent of broad money[27] (which is partly related to the fact that the Romanian economy is still cash-based)[28] (see Monetary Survey in Annex).

Ownership structure and market shares

There were 40 banks in Romania at the end of 1996. According to the type of shareholders, these banks can be split into several groups:

– fully state owned: five banks;
– domestic mixed capital (state and private): three;
– state capital and mixed private capital (foreign and domestic): four;
– state capital and foreign private capital: one;
– domestic private capital: four;
– mixed private capital (foreign and domestic): ten;
– foreign private: thirteen.[29]

This means that, out of 40 banks, 33 had private majority ownership or were joint-venture institutions. Notwithstanding this structure, the private entities accounted for less than 25 per cent of bank assets at the end of 1996. The dominance of the large state-owned banks in the banking industry is shown in Table 11: at the end of 1996, the four major state-owned banks (Romanian Commercial Bank, Bancorex, Agricultural Bank, and Romanian Development Bank) held 66 per cent of total assets, 76 per cent of total credits, 63 per cent of total deposits, 71 per cent of own capital, and 60 per cent of foreign exchange deposits.

Ownership structure has affected the way banks funded themselves. While the large state banks relied heavily on financing from the NBR, private banks resorted primarily to sight and time deposits from the general public (around 20 per cent of such deposits) and money markets (inter-bank borrowing). There are also differences in lending behaviour. State banks have financed primarily state-owned companies, whereas private banks have tended to focus more on the private enterprise sector and short-term and medium-term lending. Most of the foreign banks have catered to the needs of large domestic and foreign clients engaging in trade-related operations.

In August, 1997, the government announced that the Romanian Development Bank would be privatised in early 1998, to be followed (also in 1998) by the Agricultural Bank and Post Bank. Against the background of bad portfolios (see below), privatisation should offer the opportunity for improving corporate governance in the banking industry (see the Box).

Table 11. **The role of the major state banks in the banking system**

End of period, bank share as per cent of total

	Bank credit to non-government					Lei deposits					Foreign exchange deposits				
	1992	1993	1994	1995	1996	1992	1993	1994	1995	1996	1992	1993	1994	1995	1996
Banca Agricola	39.5	41.6	37.7	27.8	20.1	11.0	11.4	14.8	14.7	18.3	6.4	4.9	3.4	2.7	2.2
Romanian Commercial Bank	30.5	25.5	23.5	20.2	18.8	21.1	20.9	17.6	19.1	21.3	21.3	19.3	17.1	19.7	20.6
Romanian Bank for Foreign Trade (Bancorex)	14.1	12.8	13.3	20.6	29.1	9.5	9.3	10.6	10.6	14.4	42.9	44.9	37.8	32.4	27.1
Romanian Bank for Development	8.6	7.6	6.5	7.4	7.6	13.8	12.1	12.2	9.2	8.9	5.5	4.5	6.8	7.9	8.9
Subtotal	92.7	87.5	81.0	76.0	75.6	55.4	53.7	55.2	53.6	62.9	76.1	73.6	65.1	62.7	58.8
Savings Bank (CEC)	1.8	0.5	0.2	0.1	0.3	36.1	30.4	22.1	21.1	15.4	0.0	0.0	0.0	0.0	0.0
Total	94.5	88.0	81.2	76.1	75.9	91.5	84.1	77.3	74.7	78.3	76.1	73.6	65.1	62.7	58.8

Source: National Bank of Romania.

Box 5. **New legislation regarding banks**

There are three legislative initiatives on banks: the new law on the statute of the National Bank, which aims at strengthening its independence (including making more clear its fundamental mission of maintaining price stability) and improving bank supervision; the law on the judicial liquidation of banks, which tries to simplify the procedures for dealing with insolvent banks; and the banking law, which provides for the privatisation of state-owned banks.

The draft law on privatisation envisages three methods: 1) outright sale of bank shares by the State Ownership Fund; 2) a rise in the social capital, either by public or private placement; 3) a combination of the two. The SOF is entitled to keep up to a 10 per cent stake in each bank, or maintain ‘‘nominal controlling shares’’ (like golden shares). The state owned banks will be privatised on a case by case basis, under the supervision of ‘‘privatisation committees’’. The government has signalled clearly that foreign capital is allowed to participate (and in fact is to be welcomed) in these privatisations.

The dominance of the four state banks is even more dangerous – for the system as a whole – the worse the lending practices of these banks. The magnitude of the difficulties in the banking industry is indicated by the performance of the four major state-owned banks: overdue credits as a share of total non-government credit increased from 4.3 per cent at the end of 1993 to 7.1 per cent at end-1994, 13.6 per cent in 1995, 14.7 per cent in 1996, and 26.3 at the end of September 1997. What catches the eye is the surge of overdue credits in the first half of 1997. The rise of ‘‘new’’ overdue credits in 1997 may be smaller to the extent that part of this surge reflects a renunciation of rollovers – *i.e.* introducing higher transparency. But even so, it is quite disconcerting to see that overdue credits rose in a period of declining interest rates in 1995 and 1996 (Table 12).

The two most problematic banks, the Agricultural Bank and Bancorex, provide clear examples of the negative impact of past economic policies on the banking sector. These state-owned banks were compelled to lend excessively to customers – especially in the agriculture and energy sectors – who had very poor prospects for repaying loans. It should also be noted that the unreliability of these clients stemmed not just from inefficiency, poor management and other such problems, but also from external constraints (particularly price controls) that they themselves faced. Nevertheless, the result is that the two banks have high exposure to loss-making sectors, and have been overwhelmed by non-performing loans. They now have to undergo a major restructuring programme. As noted

Table 12. **Commercial banks' classified credits and risk provisions**

Billions of lei

	31/12/94	31/12/95	30/06/96	31/12/96	30/06/97
	Classified credits				
Credits granted, total (gross)	9 385.3	18 453.4	23 364.0	26 743.7	39 486.1
Standard	3 349.0	3 096.4	3 924.5	2 969.2	3 006.5
Watch	2 794.2	4 973.1	5 885.4	7 397.0	10 678.8
Substandard	1 101.6	2 591.1	2 774.0	4 878.9	4 678.5
Doubtful	1 114.3	2 528.8	3 183.1	2 690.4	4 497.5
Loss	1 026.2	5 264.0	7 597.0	8 808.2	16 624.8
Guarantees and collateral, total	7 856.4	13 203.9	16 872.9	19 478.3	27 261.0
Credits granted, total (net)	1 529.1	5 249.5	6 486.4	7 265.4	12 225.1
Standard	403.8	526.9	487.5	585.7	718.1
Watch	447.2	1 403.0	1 858.1	1 248.5	1 376.1
Substandard	184.2	664.8	646.0	1 119.9	1 171.6
Doubtful	172.3	635.3	703.7	793.1	741.3
Loss	321.6	2 019.5	2 791.1	3 518.2	8 217.9
	Risk provisions				
Risk provisions required, total	474.4	2 550.0	3 369.7	4 218.2	8 903.4
Watch	22.5	70.2	97.5	63.5	68.8
Substandard	37.0	133.2	129.2	228.5	234.4
Doubtful	89.5	317.7	351.9	404.0	370.8
Loss	325.4	2 028.9	2 791.1	3 522.2	8 229.4
Actual risk provisions, total	131.0	1 785.0	2 412.3	2 513.6	5 045.6
Watch	5.1	38.0	75.2	114.1	85.7
Substandard	13.6	72.6	141.6	152.7	303.6
Doubtful	17.6	252.7	367.7	389.3	522.9
Loss	94.7	1 421.7	1 827.8	1 857.5	4 133.4
Memorandum items:					
Ratio of doubtful and loss credits to total credits (gross) (in %)	22.8	42.2	46.1	43.0	53.5
Ratio of actual provisions to required provisions (in %)	27.6	70.0	71.6	59.6	56.7

Source: National Bank of Romania.

earlier, the government announced in September that identified losses of 3 500 billion lei (around 1.3 per cent of 1997 GDP) at the Agricultural Bank would be covered by issuance of state bonds, but that further rehabilitation steps would also be required. Bancorex, which dominated hard-currency lending in Romania, faced mounting problems in late 1996 (partly because of its hard-currency exposure to the energy sector); overdue loans (as a share of total loans to non-bank customers) more than doubled from 1995 to 1996.[30]

It could be argued that the situation of Bancorex and the Agricultural Bank tarnishes the overall picture unduly. However, even without them, the share of overdue credits in total non-government credit has increased since 1993 – indicating the persistent difficulties with financial discipline in the Romanian economy. What also needs to be highlighted is the fact that the share of private companies in the amount of overdue credits is surprisingly high taking into account their expected better governance. Thus, whereas the share of the private sector in total overdue credits was about one-third at the end of 1994, this share went up to around 60 per cent at the end of 1996 and rose to 65.7 per cent in September 1997.[31] Also relevant is the trend in overdue credits in hard currency for the private sector: this went from around 3 per cent of total non-government hard currency credits at the end of 1994 to about 14 per cent at the end of 1996, and to 69 per cent in September 1997.

Relationship between the banking system and the wider economy

The effectiveness of the banking industry depends largely on the structure and behaviour of the economy as a whole. In this respect, there are many cases of negative interactions arising in recent Romanian experience. For example, there is a paradoxical outcome of the ‘‘mutual captivity’’ between banks and large domestic enterprises, in the largely non-contestable markets of Romanian banking: many banks have been capable of extracting handsome monopoly rents (*via* wide spreads) although their actual state as ongoing concerns (taking into account the health of their clients) remains very fragile, or is even deteriorating.[32]

A mirror image of inadequate structure, of resource misallocation, is the evolution of refinancing of banks by the National Bank during 1994-1996. The increasing share of directed credits involved not only subsidised lending, but reduced the scope of manoeuvre of monetary policy and slowed down the development of policy instruments – such as open market operations. Banks have been perpetuating a pattern of resource allocation which goes against the key role they should be playing in restructuring.

Assuming that stabilisation efforts continue, the level of positive real interest rates is likely to remain quite high in the absence of substantial restructuring and without greater certainty in the economic environment. Policy inconsistency and uncertainty will deter banks from extending their time horizons, and they will also tend to raise risk premia. This state of affairs can be quite detrimental to long-term investments and risks skewing the composition of foreign capital inflows in favour of portfolio capital. It would also damage the longer term prospects for banks by intensifying problems of adverse selection among their clients. The deterioration of banks' portfolios in the first months of 1997 is a worrying signal in this regard. Furthermore, as seen in 1996, the sharp exchange rate depreciations which follow from inconsistent macroeconomic policies create significant problems for companies relying on external borrowing (especially firms that are not export oriented), and ultimately for the banking system.

The incomplete regulatory framework has also been a source of policy uncertainty and indecision, to the extent that inaction is motivated by the lack of explicit regulations. For example, the delay in dealing with the ailing banks Credit Bank and Dacia Felix was basically motivated by the unsatisfactory legal framework, although the law has both a spirit and an adjustable body of regulations. Interestingly enough, a similar argument was advanced by the National Exchange and Securities Commission in defending its attitude (inaction) with respect to the mutual fund crisis noted earlier. In addition, deficiencies in bankruptcy legislation and with the definition of property rights (especially in agriculture) have slowed the recovery of litigious loans and economic restructuring more broadly. Lack of judicial expertise, and the overburdening of the court system, have compounded these difficulties.

The current problems of the banking industry may persist, and macroeconomic stabilisation may be undermined, unless policy is consistent, privatisation is vigorous, and foreign capital is substantial. A dangerous vicious circle can be at work between macroeconomic policy and the state of the banking system unless there is deep restructuring of the economy and real interest rates come down significantly. Thus, both tightening and expansionary policies can be ambivalent as to their impact on banks: expansions can be accompanied by poor lending and unsustainable trade imbalances (as happened in the second half of 1995 and in 1996); whereas high real interest rates can damage the payment capacity of banks' clients and unleash mounting pressure for forgiveness.

III. Economic restructuring

Privatisation and enterprise restructuring

During the period 1990-94, privatisation occurred slowly. The process was hampered by lack of political will, institutional problems, slow establishment of the required legal framework, lack of consensus among political forces on the model to follow, as well as the lack of a pragmatic approach to these problems. In 1995, the government took steps towards a more active policy by launching the second Mass Privatisation Programme. From this point, the government elected at the end of 1996 accelerated the pace of privatisation. Most importantly, the privatisation policy now seems to be embedded into a wider programme of structural reforms.

The privatisation process

The 1990-94 period in retrospect

The privatisation process in Romania started in 1990. The first step was to provide a legal framework for the establishment of private economic entities and transfer of state ownership.[33] In November 1990, the organisation of commercial companies was framed.[34] In the same year, the National Commission for Small Enterprises and Services was created, to become later the National Agency for Privatisation (NAP).

This legal framework provided for the creation of a large number of small or micro-enterprises, mainly in the service sector. Initially, complicated registration procedures and difficulty in locating premises were the main problems. Subsequently, the streamlining of procedures and access to leasing outlets and workshops facilitated enterprise creation. Through the law on land restitution (Law 18/1991) private ownership made its way in the agricultural sector. The agricultural land surface under private ownership grew rapidly from 7 per cent in 1989 to more than 72 per cent by end-1996, with the private sector contributing more than 86 per cent of total agricultural output.

Two types of state-owned entities were created: *Régies Autonomes* and commercial companies. The *Régies Autonomes* (RAs), modelled on similar French entities, are equivalent to what is defined as ‘‘strategic enterprises’’ in other transition countries. They are located in such branches as the defence industry, energy production and distribution, mining, telecommunication, mail and railway systems, and some activities of regional importance, such as public utilities and regional transportation. Overall, in 1992, there were 800 RAs (both national and regional entities) which, by definition, were out of the privatisation process. Commercial companies are either joint stock or limited liability companies. In conformity with the privatisation law (Law 58/1991) the State Ownership Fund (SOF) was put in charge of state ownership, subordinated to the Parliament.

The Privatisation Law also provided the framework for the distribution of ‘‘national wealth’’ to the population. Accordingly, ownership certificates equivalent to 30 per cent of the capital of the 6 300 state-owned commercial companies listed for privatisation were distributed freely to all Romanian citizens over 18 years of age. The shares of capital privatised through this scheme were entrusted to five Private Ownership Funds (POFs), set up on a regional criterion basis for small enterprises, and on a sectoral basis for medium and large companies.[35] Banking and insurance activities were evenly distributed amongst the five funds. The rationale for the creation of five private funds was to promote decentralisation and competition among them. The resulting shareholder structure in each company was that 70 per cent of the voting rights were administered by the SOF, on behalf of the state, with 30 per cent administered by the POFs (according to size, region or activity), on behalf of the population.

In 1992, the National Agency for Privatisation started a ‘‘pilot programme’’ for privatisation of a small number of companies.[36] The NAP was also entrusted with the sale of company assets such as unutilised equipment, premises and autonomous operating units. This possibility was widely used and turned out to be an effective way to provide liquidity for the companies and premises for new businesses.

After the SOF and the POFs were finally put in place in 1992, the ownership certificates – materialised in booklets of five tradable certificates, one for each of the POFs – were distributed to the population. Each booklet’s nominal value was

25 000 lei. Citizens had the right either to keep them and be entitled to dividends paid by the POFs in five years time, or to sell them for cash or companies' shares.

The POFs were supposed to have a key role in organising the market for shares of companies shortlisted for mass privatisation. They focused instead on the value of their portfolio by using the proceeds from dividends in accumulating bank deposits, buying real estate or acquiring shares in highly valued private or state owned companies. The POFs announced quarterly the value of the certificates, but the secondary market for trading them did not develop due to the lack of the necessary institutional framework. Some certificates were exchanged largely below the book value announced by the POFs, which induced suspicion among the population about the transparency of the whole privatisation process.

As an attempt to trigger the creation of a market for trading the ownership certificates, the NAP and the SOF initiated a joint programme of public offers for three companies in 1994. The programme was designed to offer, simultaneously, shares against cash and against certificates. While the former option was hardly used, the trade of certificates against companies' shares was rather successful. The population was indeed eager for an opportunity to exchange the ownership certificates received two years earlier. Considering this success, the POFs organised in 1995 a second public offering of around 100 companies, which was equally well received by the population. Despite these positive steps, the problem of the lack of a secondary market remained basically unsolved.

During the 1993-95 period, the most widely used method of privatisation was the Management-Employee Buyout (MEBO). Given the shortage of financial resources in the private sector and the low involvement of foreign investors, this method was mainly suited just to small and medium size companies (Table 13). Moreover, the MEBOs were accompanied by favourable financial conditions. Employees were allowed to pay almost half of the capital stake by instalments, at a very low interest rate and for a period of up to 10 years.

In 1994, the MEBOs slowed down. Following a Government decision to take inflation (which had peaked at 300 per cent in 1993) into account, companies' book values were re-evaluated to 5-6 times their previous value. Since the share price was established mainly according to the book value, this re-evaluation made it more difficult to sell enterprises for cash.

Table 13. **Number of privatised companies, according to size**

	1993	1994	1995	1996	Jan.-Sept. 1997	**Total**
Small (capital below 2.5 billion Lei)	238	472	322	984	978	**2 994**
Medium (2.5-18 billion Lei)	24	110	268	238	150	**790**
Large (over 18 billion Lei)	2	12	30	25	35	**104**
Total	**264**	**594**	**620**	**1 247**	**1 163**	**3 888**

Source: State Ownership Fund.

Overall, the privatisation during the 1993-95 period gave very limited results. By 1995, only 20 per cent of companies were privatised out of those included in the privatisation programme of 1990. Not only were *Régies Autonomes* removed from the privatisation process, but also the bulk of large commercial companies in industry and agriculture remained under state ownership. The slow pace of privatisation was also aggravated by other factors. First, the SOF became a rather politicised institution and its activities were poorly co-ordinated with other governmental bodies. Second, the SOF was reluctant to take any action to divest itself of shares and the overall aversion to bankruptcy meant that many of the enterprises which could not be privatised were not liquidated.[37] Finally, because of lack of incentives, the POFs did not make use of a provision in the Law allowing them to privatise medium-sized companies through a special mandate from the SOF. In the course of 1994, long debates took place in the Parliament on how to speed up privatisation.

The 1995 Mass Privatisation Programme

In 1995, a Law to Accelerate Privatisation (Law 55/1995) was finally enacted. The new Mass Privatisation Programme (MPP) was meant to restore the population's confidence in the ownership certificates and to allow all citizens to use these papers. The main provisions introduced by the Law 5 were as follows:

- new *coupons* to be distributed to all citizens over 18 years, except those who had already used their previous certificates of ownership. The face value of these coupons was established at 975 000 lei each, while the value of the certificates from the first MPP remained at 25 000 lei;

- the coupons were non transferable and could not be sold for cash, only for shares in a company or for shares in a POF;
- the capital stake in each company to be distributed increased from 30 per cent to a maximum of 60 per cent. More precisely, this meant that, in case of high demand, the SOF was required to make available up to 60 per cent of the capital (in these cases, the subscribers received a decreased number of shares determined by the over-subscription ratio). Nonetheless, a still unresolved issue is the compensation from the POFs to the SOF for the additional shares offered by the latter;[38]
- the law concerned around 4 000 companies initially, which after splits increased to 5 700. This limited number was supposed to enable a better matching between supply and demand for shares. Still, the distributed coupons did not exceed 68 per cent of the total capital value estimated at around 25 trillion lei;
- when appropriate, up to 60 per cent of the proceeds from the sale of the company could be given back to the company to repay debts or for new investments.

Almost 15 million citizens (or 91 per cent of the adult population) obtained and used the coupons. Over 85 per cent of the coupons were exchanged directly for company shares and a mere 15 per cent was placed with the POFs. Out of the initial 4 000 companies, around 1 300 were oversubscribed, *i.e.* the 60 per cent limit was reached. In these cases, the Romanian subscribers received a decreased number of shares determined by the over-subscription ratio. In addition, the SOF selected a group of 500 enterprises where at least 51 per cent of equity would be retained for strategic investors (including foreigners).

The obligation for the SOF to transfer shares up to 60 per cent of the capital accelerated the pace of privatisation. Many small companies and a few large companies were privatised (Table 13). An important point was the increasing familiarity in the public regarding share transactions. An over-the-counter market (RASDAQ), based on the US NASDAQ model, was established to trade the equity between the POFs and individuals, also enabling the SOF to use this market as a means of privatisation. With more than 3 000 companies being listed by mid-1997, this market is participating actively in the development of capital markets in Romania. The POFs were transformed into Financial Investment Companies at end-1996.

The privatisation policy since early 1997

The new government faced major challenges regarding the design and implementation of the privatisation strategy. The need to accelerate the pace and scope of privatisation is indicated by the lack of progress achieved to that point. While many small enterprises have been privatised, the process has extended to only a few of the large industrial companies and the *Régies Autonomes* remained largely unrestructured. Overall, only 10 per cent of equity[39] had been transferred to the private sector (not including the implicit equity of RAs).

An important decision was to let sale prices be determined by market value rather than by book value. In this way, the SOF expects to sell enterprises ''as they are'', *i.e.* possibly with their stock of financial liabilities (inter-enterprise arrears, state arrears), rather than restructuring enterprises before their sale (see below). Enterprises that do not find a buyer at market prices are candidates for liquidation. As part of the negotiations between the Romanian government and international lending institutions, the SOF is committed to offer an average of 50 companies per week during 1997.

From an institutional point of view, the SOF has now become responsible to the government where previously it reported to the Parliament. While there are risks in this approach, this change has the potential to improve co-ordination between government policy-makers and the SOF, and hence improve implementation of government policy. Improved co-ordination between the competition authorities and the SOF is also important, given that the interaction between provisions of the Competition Law and the laws governing the SOF are not entirely clear.[40] In any event, the SOF should co-ordinate with the Competition Council both to learn about potential competition problems, and to eliminate or minimise the possibility that a privatization could be delayed.

There has been a shift in the main methods of privatisation used by the SOF. Previously, most companies were sold by tenders to employees and managers and only around 500 enterprises were sold by auctions. The latter method is now increasingly been used, improving the speed and transparency of the sales' process. The SOF is also using direct sales to strategic investors with the support of four international investment banks, each responsible for ten to twenty large companies. However, by end-September, only six companies had been sold in this way. The SOF has decided to privatise 22 companies through the capital markets: five through the BSE and 17 through the RASDAQ. On

24 October 1997, the first auction through the RASDAQ system was held, with five companies offered and one sold.

Questions remain concerning whether the SOF has the resources to carry out the desired pace of privatisation. For example, from the 2 710 companies in the privatisation programme for 1997, 47 per cent of this number had been achieved by end-October. The companies that have been sold still tend to be the smaller, easier to privatise, cases whereas many large companies remain in the SOF portfolio. The SOF is also in charge of the liquidation of the companies generating high losses or unable to pay their debts to the state budget and suppliers.

Nevertheless, recent efforts to speed up privatisation are reflected in the increase in the share of privatised equity from 10 per cent at end-1996 to 16 per cent at end-September. This accounts for 44.5 per cent of the initial number of companies to be sold.

Looking at the sectoral breakdown, the highest rates of privatisation have been achieved in footwear, construction, domestic trade and textiles (Table 14). In most sectors, more than 70 per cent of the value-added is produced by the private sector except for industry where the share was 35 per cent in 1996 (Figure 20). Altogether, the private sector accounted for 52 per cent of 1996 GDP. Private companies were employing, however, only 38.5 per cent of the total labour force by end-96.

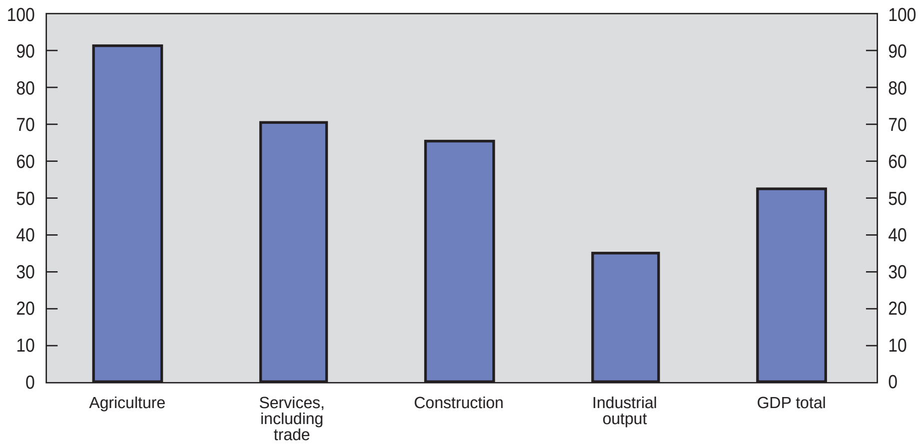
Table 14. **Sectors with highest rates of privatisation, end-September 1997**

	Number of privatised companies	In % of total number of enterprises to be privatised
Leather, footwear	34	68.0
Construction	385	57.0
Trade	1 027	55.2
Training	25	52.1
Textiles, garments	176	51.8
Rubber, plastics	32	49.2
Glass, construction materials	74	48.7
Wood, paper	77	48.4
Hotels, restaurants	184	46.8
Agriculture	970	43.6

Source: State Ownership Fund.

Figure 20. **WEIGHT OF PRIVATE SECTOR IN SECTORAL GDP, 1996**

Per cent



Source: National Commission for Statistics.

The restructuring of large state-owned companies and Régies Autonomes

At the end of 1996, there were 281 active RAs. Restructuring has been lagging behind due to the combined effect of a slow pace of privatisation, lack of corporate governance structures and inadequate surveillance by the SOF over the enterprises under its control. At the same time, ill-defined property rights remained, particularly among the large state-owned *Régies Autonomes*, whose managers were by and large unresponsive to market incentives. Moreover, restructuring was mainly understood by the SOF as financial support. Overall, this support was misdirected as the largest proportion went to heavy industry, base chemicals and agriculture and was used to pay wages.

In order to address more specifically the restructuring of the large-scale companies, the government created another body in 1994 – the Restructuring Agency. This agency was mandated to draft restructuring projects for 200 companies identified in the Government decree 445/94, while the SOF would provide the financing of these projects. In 1995, a new government decree (212/95) defined a narrower set of 151 entities to be placed under surveillance. The Restructuring Agency was made responsible for 120 state-owned commercial companies, and the line Ministries (Industry, Agriculture, etc.) for the remaining 9 *Régies Autonomes* and 22 commercial companies. Overall, the 151 companies accounted for approximately 30 per cent of total arrears and 50 per cent of the losses in the economy. Over the same year, the list was further reduced to 130 companies (the often quoted Ordinance 13/95), with the assistance of the World Bank and the USAID-sponsored advisor.

Between 1994 and 1996, only 9 companies under restructuring were privatised. Other attempts to restructure met with only limited success. For example, in the agricultural sector, a major restructuring in the cereal market was sought through the breaking-up of the grain storage monopoly (ROMCEREAL) into 41 regional commercial companies. These entities started to operate in April 1996, but ROMCEREAL rapidly resumed its activity in the form of a holding company.

The situation in the *Régies Autonomes* under the surveillance of the line Ministries became particularly critical. In fact, these companies had not been subject to hard-budget constraints and their financial situation worsened. At end 1996, the amount of arrears for the whole economy amounted to around 36 per cent of GDP, of which the RAs represented 7 per cent (Table 15).

More detailed data in Table 15 for 13 big *Régies Autonomes* illustrate the difficult financial situation at the end of 1996. For some companies, subsidies had to cover more than 100 per cent of turnover. The accumulated arrears represented 29 per cent of the annual turnover. That the financial situation was particularly desperate in the mining sector (*e.g.* CUPRULUI and CARBUNELUI) explains why the liquidation of these companies was one of the priorities in the restructuring programme approved in 1997. The generalised lack of financial discipline affects both sides of the balance sheets of the RAs and makes it difficult to assess their true financial situation. For example, part of the considerable arrears accumulated by RENEL and ROMGAZ – the two biggest RAs in terms of turnover – reflects a systematic non-payment of the energy bills under a generalised absence of hard budget constraints in these areas.[41] With such behaviour widespread, the threat of power and energy cuts could just not be applied in a credible way.

After the 1996 elections, there was a radical change concerning restructuring.[42] The previous Ordinance 13/95 establishing a list of companies

Table 15. **Financial indicators of the major *Régies Autonomes***

Ranking turnover 31/12/96			Number employees	Turnover bn lei	Profit/turnover			Subsidies/turnover		Arrears/turnover	
			31/12/96	31/12/96	1/1/1996	31/12/96	30/6/97	31/12/96	30/6/97	31/12/96	30/6/97
1	RENEL	Production, transport and distribution of electric and thermal power, of gas and hot water	96 111	7 123	0.1	–15.1	4.0	4.0	0.0	32.8	44.3
2	ROMGAZ	Petroleum and natural gas extraction	23 060	3 561	8.1	3.6	17.3	0.0	0.0	19.4	35.4
3	PETROM	Petroleum and natural gas extraction	62 450	3 140	–6.7	3.7	27.2	0.0	0.0	6.2	25.5
4	SNCFR	Land transport, and transport *via* pipelines	139 241	1 879	–37.3	–32.8	Loss (n.a.)	21.9	11.6	62.1	91.0
5	Agentia Nationala a Produselor Agricole	Wholesale trade (except for motor vehicles and motorcycles)	7 098	1 694	–4.1	–7.0	Loss (n.a.)	11.0	0.5	27.3	46.4
6	LIGNITULUI	Extraction and processing of coal	51 060	1 408	–8.3	–6.4	2.4	13.5	3.7	41.8	64.7
7	TUTUNULUI	Manufacture of tobacco industry	6 615	628	11.3	16.4	24.8	0.0	0.0	8.2	9.6
8	Administration nationala a Drumurilor	Construction	14 793	178	–56.9	5.0	Loss (n.a.)	233.6	19.4	10.2	10.6
9	CUPRULUI	Extraction and processing of metallic ores	26 319	149	–10.8	–59.8	Loss (n.a.)	221.2	98.8	100.2	165.9
10	CARBUNELUI	Extraction and processing of coal	16 790	142	–5.9	–59.0	Loss (n.a.)	102.1	35.8	113.3	152.0
11	METROREX	Land transport, and transport *via* pipelines	6 338	41	–22.5	–13.7	Loss (n.a.)	250.2	201.5	0.0	40.6
12	Bucharest-Otopeni airport	Air transport	900	36	0.0	20.7	27.9	158.6	0.0	3.8	0.0
13	CAI de RASA	Agriculture and related services	968	3	13.7	0.6	Loss (n.a.)	143.4	390.0	91.9	440.0
	Total 13 RAs		*451 743*	*19 983*	*–4.2*	*–8.6*	*Loss (n.a.)*	*10.7*	*2.8*	*29.2*	*44.2*
	Total RAs		*973 160*	*28 155*	*n.a*	*n.a*	*n.a*	*10.7*	*6.6*	*27.7*	*42.8*
	Total economy		*5 039 798*	*213 629*	*n.a*	*n.a*	*n.a*	*2.1*	*1.3*	*18.5*	*32.7*
Memorandum items:			Number of employees/ total employees	Turnover/ total turnover	Profit/GDP			Subsidies/GDP		Arrears/GDP	
Total 13 RAs in %			9.0	9.4	–0.8	–1.6	..	1.9	..	5.3	..
Total RAs in %			19.3	13.2	..	..	..	2.8	..	7.1	..
Total economy in %			100	100	..	..	..	4.1	..	36.1	..

Source: Ministry of Finance.

under state supervision was cancelled. In effect, this Ordinance ended up delaying the restructuring process for these companies. In the new approach restructuring means rapid privatisation of viable companies and liquidation of the non-viable economic agents through the court or administrative procedures (*e.g.* using SOF ownership rights). Notably, *all* RAs are to be restructured into commercial companies or ''national'' companies,[43] and some activities are to be closed. The RAs in public utilities, together with large loss-making companies are being considered first. The restructuring process, as drafted by the line ministry, will occur case by case in no more than six months (according to the draft Law), and will be implemented by the line ministry for national companies, and by the SOF and local authorities for the others. The proceeds of the sales of shares are to be distributed as follows: 20 per cent to the state/local budget, 60 per cent to the company, for the payment of debts and investment, and 20 per cent to a special Development Fund for fostering small enterprise development. It is noteworthy that article 2, No. 3 of the draft Law provides for the state to keep a stock of shares or a ''golden share'' in some of the companies without specifying which sectors or activities are concerned.

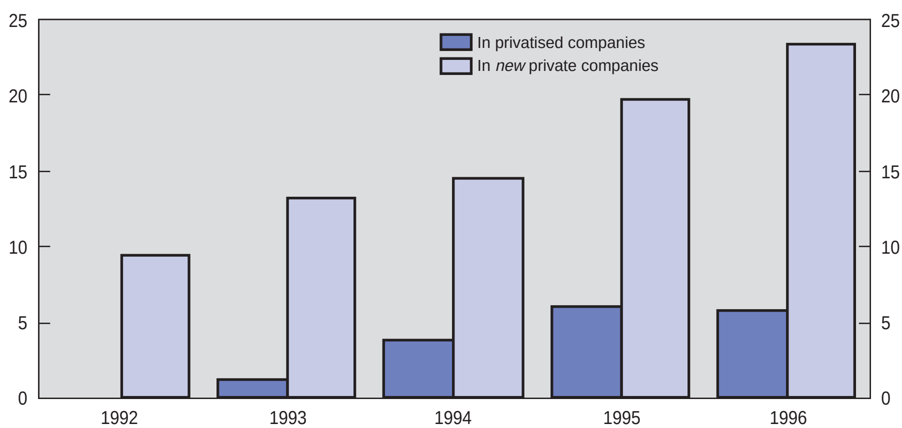
As the restructuring plans of most of the RAs are now being elaborated by the line Ministries, it is too early to assess their effectiveness. As noted in chapter I, only the RAs in the mining sector have started to lay-off part of their labour force. In September 1997, a National Oil Company was created, integrating (vertically) the exploration of oil and gas resources, refining and retail distribution of oil products. Given the large size of the companies, the success of this new phase of restructuring will very much depend on the participation of strategic investors; foreign direct investment could play a crucial role in this process. There has been a tremendous effort during 1997 to put in place the necessary legislative framework for restructuring to occur. A concern is that implementation will not be in proportion to this effort so far, and the past experiences of Romania in this area are not encouraging. However, the present government appears much more determined than its predecessors to pursue deep restructuring. This political will still appears to maintain a broad base of support in Romania. In addition, it is reflected in the renewed participation of the international financial institutions and of foreign investors.

Development of a new private sector

The experience of the most advanced transition countries suggests that, ultimately, a deep economic restructuring can only be achieved by the creation of a new private sector. Nonetheless, the release of former state-owned resources (including public funds) has a crucial role for the surge of private business. Thus the acceleration of privatisation is important but, to be effective, it needs to be supported by policies providing the right environment for the development of SMEs, increased labour mobility and re-conversion of workers in the mono-industry regions. Without this coherent approach the imbalance between the exit and entry of enterprises and workers can exacerbate transitional costs.

Supporting this point, employment creation in the new private firms is higher than in privatised units (Figure 21). This fact is confirmed by several other studies for Romania and other Eastern European countries.[44] The employment creation performance has been systematically much higher in the newly created units than in surviving firms (either still state-owned or privatised). Privatised

Figure 21. **EMPLOYMENT IN PRIVATISED AND NEW PRIVATE COMPANIES**
Percentage of total employees



Source: SOF, National Commission for Statistics.

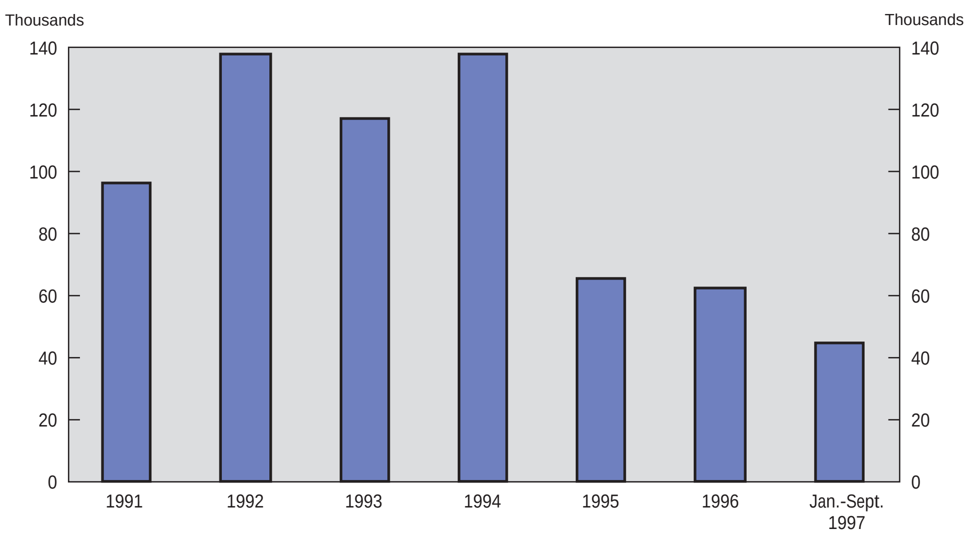
and state enterprises did not perform much differently one from another (see EBRD, 1995).

Promoting entrepreneurship

In Romania, as in most transition countries, the boom of enterprise creation took place in the early years of transition (Figure 22). Small and medium sized private enterprises began to develop in the early 1990s. The fragmentation of some of the previous large-scale firms through MEBOs and the sales of state-owned assets provided room and resources for these new entities. More than 645 000 new private firms were created from December 1990 to September 1997, of which individual entrepreneurs account for about 10.5 per cent.

A new class of entrepreneurs emerged. Some benefited from experience in their previous activity in state enterprises and personal connections with banks and clients. This type of entrepreneurship developed mainly in the area of foreign trade, as well as in highly specialised segments of the manufacturing and service sectors (textiles, construction, furniture and enterprise services). Young, often

Figure 22. **NUMBER OF NEWLY ESTABLISHED ENTITIES**



Source: SOF.

inexperienced, people typically with university education and prone to engage in new businesses were another source of entrepreneurship. Because of the difficult access to capital, they engaged in business areas with lower entry costs, such as trade and services.

Access to financing is one of the most critical factors hampering the growth and development of private businesses. With high interest rates and depressed demand, due to the severe macroeconomic stabilisation policies, small companies suffer severe liquidity constraints. Lack of administrative support is also an important barrier for the development of private firms. Because most of the restructuring problems are related to the existing large industrial companies, governmental policy has, so far, concentrated on them. Some of the government's efforts should be devoted from now on to the promotion of entrepreneurship and development of a new private sector. In this regard, the government is currently preparing a strategy towards SME development.

Foreign trade and restructuring

A dual trade structure

Romanian foreign trade is characterised by a specialisation in both low-skilled labour-intensive products and capital-intensive industries. This apparent dichotomy reflects the dual structure of the Romanian economy and its legacies. The specialisation in labour-intensive industries is the natural outcome of a relatively abundant and cheap labour force. The persistent specialisation in capital-intensive industries is the result of the previous production structure. The fact that the large set-up costs, for example of an iron and steel plant or a petrochemical company, have already been incurred may compensate for the high operating costs in the short-run. Moreover, during the transition period, policies have continued to provide state support to these industries. In this context, the rapid trade liberalisation may have exacerbated the dual structure of the economy due to high foreign demand for these products and Romania's competitive prices in world markets.

Table 16 provides the main (revealed) comparative advantages and disadvantages at the two-digit level of the SITC Classification.[45] The first observation is the high degree of concentration of exports. Articles of apparel and clothing

Table 16. **Trade structure of the Romanian economy, 1996**

SITC code	Main comparative advantages	RCA[1] 1990	RCA[1] 1993	RCA[1] 1996	Export share[2]	Cumulative share of exports[2]
84	Articles of apparel and clothing accessories	7.1	11.4	17.6	19.3	19.3
67	Iron and steel	7.5	12.5	7.5	10.8	30.0
82	Furniture and parts thereof	6.2	7.6	5.5	6.0	36.0
85	Footwear	2.1	2.5	5.1	6.2	42.2
56	Fertilisers, manufactured	1.6	3.4	4.3	4.4	46.6
04	Cereals and cereal preparations	–2.2	–6.1	3.3	3.8	50.4
24	Cork and wood	1.0	2.0	2.6	2.7	53.1
79	Other transport equipment	3.8	0.8	2.4	2.9	56.0
68	Non-ferrous metals	1.9	1.9	2.0	2.9	58.9
66	Non-metallic mineral manufactures n.e.s.	1.2	2.1	1.3	2.6	61.5
52	Inorganic chemicals	0.7	0.5	0.9	1.5	63.1
00	Live animals chiefly for food	–0.3	1.1	0.8	0.9	64.0
42	Fixed vegetable oils and fats	–0.3	1.1	0.7	0.8	64.8
01	Meat and meat preparations	–2.4	1.6	0.6	0.8	65.6
57	Plastics in primary forms	1.1	0.3	0.6	1.3	66.9
11	Beverages	0.0	–0.2	0.6	0.7	67.6
63	Cork and wood manufactures, excl. furniture	1.1	0.9	0.4	0.8	68.4
83	Travel goods, handbags and similar containers	0.0	0.2	0.1	0.2	68.6
71	Power-generating machinery and equipment	0.3	0.7	0.1	1.3	69.9
62	Rubber manufactures n.e.s.	0.2	–0.4	0.1	0.7	70.6

SITC code	Main comparative disadvantages	RCA[1] 1990	RCA[1] 1993	RCA[1] 1996	Import share[2]	Cumulative share of imports[2]
65	Textile yarn, fabrics, made-up art., related products	1.7	–4.8	–7.1	9.2	9.2
33	Petroleum, petroleum products and related materials	–7.5	–5.5	–5.5	12.6	21.8
34	Gas, natural and manufactured	–5.3	–6.3	–5.4	5.4	27.2
72	Machinery specialised for particular industries	1.5	–2.9	–4.7	6.1	33.3
74	General industrial machinery and equipment and parts	1.5	–0.3	–2.6	5.4	38.7
32	Coal, coke and briquettes	–4.4	–3.2	–2.6	2.8	41.5
77	Electrical machinery, apparatus and appliances n.e.s.	–0.5	–1.9	–2.3	4.5	45.9
76	Telecommunications, sound recording apparatus	–1.3	–2.5	–2.2	2.4	48.3
28	Metalliferous ores and metal scrap	–2.6	–1.6	–2.1	2.1	50.5
61	Leather, leather manuf. n.e.s. and dressed furskins	0.0	–1.1	–1.9	2.1	52.5
59	Chemical materials and products n.e.s.	–2.1	–1.5	–1.8	2.0	54.6
75	Office machines, automatic data-processing equip.	–0.6	–1.6	–1.8	1.8	56.4
89	Miscellaneous manufactured articles n.e.s.	0.2	–0.4	–1.6	3.1	59.5
06	Sugar, sugar preparations and honey	–1.1	–1.1	–1.4	1.5	61.0
87	Professional, scientific and controlling instruments	–0.6	–0.9	–1.3	1.5	62.5
54	Medicinal and pharmaceutical products	–1.1	–1.3	–1.2	1.7	64.2
55	Essential oils, perfume materials, toilet-cleansing mat.	–0.4	–0.6	–1.2	1.3	65.5
53	Dyeing, tanning and colouring materials	–0.4	–0.9	–1.0	1.1	66.6
93	Special transactions not classified accord. to kind	0.0	0.0	–1.0	1.0	67.6
64	Paper, paperboard, paper articles, paper-pulp/board	0.3	–0.4	–1.0	1.6	69.3

1. RCA: revealed comparative advantage indicator (Xi/X – Mi/M), see text.
2. As percentage of total exports or imports in 1996.

Source: National Commission for Statistics

(SITC 84) alone represent 19 per cent of exports, and iron and steel 10 per cent. Overall, the top 20 products cover 70 per cent of the export turnover. The major change in the specialisation patterns is located in the textile sectors. Romania is now displaying a large export surplus in apparel and clothing segments while the largest deficit is in the intermediate textile products. This reflects the large subcontracting activities which are taking place with western European countries (mainly Italy and Germany). The textile materials are imported, processed then re-exported.[46] More than 30 per cent of the trade turnover in Romania[47] is now done via subcontracting to a dense network of small enterprises. These activities are widespread in Central and Eastern Europe but in Romania they have intensified over recent years because of the even lower wage costs. Subcontracting can be a good way of developing business relations and learning about product design. Produced by a fringe of flexible, small-scale enterprises it also provides much flexibility to export activity and certainly explains the fast recovery of trade flows after the transition shock. It generates, however, a high dependence of exports on imports of intermediate goods.

In a similar way, the specialisation in iron and steel products needs intense imports of energy and iron ores. Whether these trade flows will survive depends on how fast and well these enterprises adjust to market input prices and hard budget constraints.

The role of trade in job creation and destruction

It is interesting to link these trade patterns with changes in employment and enterprise creation. In the first panel of Table 17 are displayed the sectors with the highest net employment destruction whereas the lower panel shows the sectors which have created (or destroyed fewest) jobs. Between 1992 and 1996, the Romanian economy had a net job loss of 545 000 (or 11 per cent of employment) and created a net 182 000 enterprises. Some sectors contributed disproportionately to this change. For example, the wood furniture and the manufacture of textiles alone represent 200 000 net jobs destroyed. This change occurred mainly in the large enterprises. As a counterpart, the manufacture of wood products and of textile apparel and wearing created a net 70 000 jobs.

These figures illustrate the impact of trade liberalisation on industrial restructuring. Overall, there was a remarkable increase in productivity in many industrial sectors (Table 18). However, the effects of comparative advantages are

Table 17. **Net job creation and destruction by enterprise size, 1992-96**

ISIC rev 3	Title	Change in number of employees: Total	Total growth rate in %	0-9 employees	10-49 employees	50-249 employees	over 250 employees	Change in number of enterprises: Total	0-9 employees	10-49 employees	50-249 employees	over 250 employees
A.	**Sectors with highest net employment destruction**											
36	Manufacture of furniture, manufacturing N.E.C.	–103 356	–43.4	1 815	2 469	11 375	–119 015	702	513	117	99	–27
17	Manufacture of textiles	–96 033	–34.0	1 617	2 479	11 646	–111 775	883	709	119	101	–46
60	Land transport, transport via pipelines	–83 251	–22.8	4 228	4 416	19 735	–111 630	4 227	4 049	198	158	–178
29	Manufacture of machinery and equipment N.E.C.	–57 073	–16.7	307	1 756	5 607	–64 743	105	–3	85	45	–22
74	Other business activities	–39 006	–36.4	4 616	2 968	4 419	–51 009	3 874	3 747	130	27	–30
35	Manufacture of other transport equipment	–33 813	–28.3	267	522	1 188	–35 790	95	72	25	7	–9
28	Manufacture of fabricated metal products, except machinery and equipment	–32 792	–22.8	1 710	5 886	10 236	–50 624	980	621	293	88	–22
27	Manufacture of basic metals	–26 920	–14.1	147	562	1 379	–29 008	141	104	21	15	1
26	Manufacture of other non-metallic mineral products	–25 723	–17.1	688	1 470	6 138	–34 019	281	166	74	51	–10
11	Extraction of crude petroleum and natural gas	–23 585	–23.0	11	150	475	–24 221	13	5	6	2	0
31	Manufacture electrical machinery and apparatus N.E.C.	–22 862	–24.9	361	478	2 265	–25 966	149	108	26	18	–3
33	Manufacture of medical, precision and optical instruments, watches and clocks	–17 206	–45.9	176	506	979	–18 867	78	49	27	8	–6
45	Construction	–15 041	–3.2	6 103	21 975	65 157	–108 276	2 716	1 301	1 015	520	–120
24	Manufacture of chemicals and chemicals products	–14 886	–10.0	640	1 707	4 487	–21 720	288	184	74	36	–6
73	Research and development	–14 711	–22.3	–152	–38	8 055	–22 576	–15	–26	–8	50	–31
Subtotal		–606 258	–21.3	22 534	47 306	153 141	–829 239	14 517	11 599	2 202	1 225	–509

Table 17. **Net job creation and destruction by enterprise size, 1992-96** *(cont.)*

ISIC rev 3	Title	Change in number of employees: Total	Total growth rate in %	0-9 employees	10-49 employees	50-249 employees	over 250 employees	Change in number of enterprises: Total	0-9 employees	10-49 employees	50-249 employees	over 250 employees
B.	**Sectors with highest net employment creation**											
20	Manufacture of wood and products of wood and cork except furniture	42 064	105.0	4 242	6 908	6 567	24 347	2 139	1 715	346	68	10
51	Wholesale trade and commission trade, except motor vehicles and motorcycles	32 221	19.8	26 476	17 696	22 054	–34 005	32 195	31 206	865	207	–83
18	Manufacture of wearing apparel, dressing and dyeing of fur	27 805	16.1	3 266	7 407	24 556	–7 424	1 599	1 028	340	221	10
52	Retail trade, except motor vehicles and motorcycles; repair of personal and household goods	25 193	6.2	121 433	39 119	29 546	–164 905	105 947	103 474	2 350	290	–167
40	Electricity, Gas, steam and hot water supply	23 679	15.4	25	248	4 773	18 633	42	6	8	33	–5
50	Sale, maintenance and repair of motor vehicles and motorcycles, retail sale of automotive fuel	17 692	45.3	9 124	8 821	10 455	–10 708	8 197	7 657	454	91	–5
63	Supporting and auxiliary transport activities, activities of travel agencies	4 911	15.0	–109	–466	2 283	3 203	199	214	–28	14	–1
92	Recreational, cultural and sporting activities	3 441	15.6	439	838	3 262	–1 098	632	558	35	34	5
41	Collection, purification and distribution of water	3 317	6.2	14	184	3 871	–752	25	–4	5	29	–5
64	Post and telecommunications	2 564	2.7	410	1 904	3 606	–3 356	293	177	87	30	–1
85	Heath and social work	1 114	46.3	502	625	–13	0	1 318	1 280	38	0	0
62	Air transport	988	22.7	–6	–40	386	648	–1	–4	–1	2	2
22	Publishing, printing and reproduction of recorded media	660	2.6	1 098	3 172	3 890	–7 500	578	409	134	44	–9
70	Real estate activities	308	2.6	472	732	1 769	–2 665	391	346	42	14	–11
93	Other service activities	99	0.4	3 260	–641	1 934	–4 454	5 131	5 162	–31	6	–6
Subtotal		186 056	14.9	170 646	86 507	118 939	–190 036	158 685	153 224	4 644	1 083	–266
Memorandum items:												
Total variation 1992-96		–544 571	–10.6	210 765	163 689	322 798	–1 241 823	181 820	171 719	8 308	2 706	–913
Levels in 1992		5 121 637		184 861	182 307	266 503	4 487 966	129 731	113 866	9 792	2 548	3 525

Source: National Commission for Statistics.

Table 18. **Employment, output and productivity growth, 1992-96**

ISIC rev 3	Title	Change in employment	Growth rate in %			Structure of employment in %		Structure of industrial production in %	
			Employment	Output	Productivity	1992	1996	1990	1995
11	Extraction of crude petroleum and natural gas	–23 585	–23.0	–4.7	23.8	3.2	2.9	3.6	6.8
10	Mining of coal and lignite	–8 066	–6.7	7.1	14.7	3.8	4.2	2.2	1.0
13	Mining of metal ores	–7 638	–12.2	5.4	20.0	2.0	2.0	0.5	0.5
14	Other mining	–6 544	–25.2	–16.4	11.8	0.8	0.7	0.5	0.6
36	Manufacture of furniture, manufacturing N.E.C.	–103 356	–43.4	184.3	402.6	7.5	4.9	2.6	2.2
17	Manufacture of textiles	–96 033	–34.1	–19.8	21.7	8.9	6.8	3.7	6.8
29	Manufacture of machinery and equipment N.E.C.	–57 073	–16.7	54.9	85.9	10.8	10.5	5.8	9.3
35	Manufacture of other transport equipment	–33 813	–28.4	25.5	75.3	3.8	3.1	1.5	2.3
28	Manufacture of fabricated metal products, except machinery and equipment	–32 792	–22.8	–3.7	24.8	4.5	4.1	2.8	4.1
27	Manufacture of basic metals	–26 920	–14.1	31.2	52.8	6.0	6.0	10.4	8.5
26	Manufacture of other non-metallic mineral products	–25 723	–17.1	8.2	30.6	4.7	4.6	3.8	3.5
31	Manufacture electrical machinery and apparatus N.E.C.	–22 862	–25.0	163.7	251.4	2.9	2.5	2.0	2.5
33	Manufacture of medical, precision and optical instruments, watches and clocks	–17 206	–45.9	64.1	203.4	1.2	0.7	0.4	1.1
24	Manufacture of chemicals and chemical products	–14 886	–10.0	–1.4	9.6	4.7	4.9	8.7	7.3
15	Manufacture of food products and beverages	–13 510	–4.7	–3.2	1.5	9.1	10.1	16.3	14.4
25	Manufacture of rubber and plastic products	–13 482	–21.8	–5.5	20.8	2.0	1.8	2.1	2.6
34	Manufacture of motor vehicles, trailers, and semi-trailers	–9 594	–8.2	43.4	56.2	3.7	3.9	3.0	3.7
23	Manufacture of coke, refined petroleum products and nuclear fuel	–9 430	–24.4	7.8	42.5	1.2	1.1	7.7	6.9
19	Tanning and dressing of leather; manufacture of luggage, saddlery, harness and footwear	–9 030	–10.2	8.3	20.6	2.8	2.9	1.5	1.9
32	Manufacture of radio, television, and communication equipment and apparatus	–5 740	–23.4	483.7	662.2	0.8	0.7	0.9	0.8
21	Manufacture of paper and paper products	–5 306	–15.8	10.7	31.4	1.1	1.0	1.2	1.2
30	Manufacture of office, accounting and computing machinery	–3 799	–58.7	12.1	171.5	0.2	0.1	0.2	0.5
37	Recycling	–1 775	–22.3	–11.4	14.0	0.3	0.2	0.3	0.2
16	Manufacture of tobacco	–1 058	–13.5	–4.1	10.9	0.2	0.2	0.5	0.5
22	Publishing, printing and reproduction of recorded media	660	2.6	308.5	298.1	0.8	0.9	1.1	0.3
18	Manufacture of wearing apparel, dressing and dyeing of fur	27 805	16.1	134.3	101.8	5.4	7.4	2.1	3.6
20	Manufacture of wood and products of wood and cork except furniture	42 064	106.0	–21.0	–61.6	1.3	3.0	1.9	1.6
41	Collection, purification and distribution of water	3 317	6.2	89.5	78.4	1.7	2.1	1.0	0.2
40	Electricity, gas, steam and hot water supply	23 679	15.4	6.7	–7.6	4.8	6.5	11.6	5.0
	Total Industry	–451 696	–14.2	25.8	46.6	100	100	100	100

Source: National Commission for Statistics.

apparent. Taking again the aforementioned examples, in the textile sector, Romania abandoned part of textile manufacturing in large-scale companies and is now importing textile intermediate goods, which are reprocessed in the SMEs specialised in clothing and apparel. In the wood industry, there was a significant downsizing of the furniture industry and a concomitant increase of employment in basic wood products. In both cases, the low-skilled labour-intensive segments replaced the capital-intensive high-skilled ones. This adjustment was difficult to avoid, as market forces selected the segments in both industries which were relatively the most competitive. The problem is that employment creation in the SMEs has compensated for only approximately half of the downsizing in large-scale companies. Moreover, the still existing human capital skills, if not used, may depreciate rapidly. These adjustments put the economy under ''strain''[48] and point again to the need to combine policies promoting enterprise creation with labour mobility in a favourable macroeconomic framework for restructuring to be oriented towards market demand.

Broadly speaking, employment creation has been located in the service sectors[49] while the traditional capital-intensive or high-skill industries were the most affected by the decrease in employment. Typically, some of the goods produced in the industrial sectors are now imported, as shown by the (above) analysis of the trade structure. Over the long run, the catch-up process will probably enable Romanian companies to climb the quality ladder,[50] but this will require time.

Trade policy

Romania is a member of the WTO but has also signed a number of free-trade agreements on a regional and bilateral basis. Compared with other former socialist countries, trade with developing countries' markets was relatively more developed. This was reflected in the signature of the protocol of trade negotiations among developing countries in 1978 and the global system of trade preferences (GSTP) among developing countries in 1988. On the 1st of May 1993, a free-trade agreement with EFTA countries and the interim Association Agreement with the EU entered into force (the EU Association Agreement was ratified in 1995). Romania also has free-trade agreements with Turkey, Moldova, Czech Republic and Slovakia. In 1997, Romania became a member of the CEFTA (Central European Free-trade Agreement).

The trade regime is relatively liberal for most products. For agricultural and food products, the present government has reduced the average (non-weighted) tariffs from 121.7 to 31.8 per cent. Romania does not apply any quantitative restriction to imports. Some restrictions on exports are applied for environmental reasons (in the case of wood), for preservation of mineral resources (ferrous and non-ferrous metals, precious metals, marble) and biological products (*e.g.* blood).

Concerning trade barriers faced abroad by Romanian producers, one of the most evoked problems is the possibility to obtain visas. At recent meetings of the EU-Romanian Association Council, the Romanian authorities criticised the EU's reluctance to lift requirements on Romanian citizens entering the EU. While a visa requirement is not by itself a barrier, the administrative requirements and long waiting lists at the European Embassies are perceived by Romanian businessmen as an effective barrier for trade and business developments with their European partners.

Promoting foreign investment

The present government has manifested an open approach to foreign investment. The factors that may attract FDI in Romania are the low labour costs and the still large room for foreign investors with respect to the size of the country. The Romanian Development Agency assists foreign investors.

From an institutional standpoint, Romania's regulatory regime for foreign direct investment is non-discriminatory. There is no general *ex ante* screening procedure by which the authorities would determine whether a foreign direct investment should be authorised. In order to have access to fiscal incentives, foreign investors need to register with the Romanian Development Agency. All forms of establishment are permitted, including subsidiaries, branches, and mergers and acquisitions involving domestic firms.

An amendment passed in April 1997 to the 1991 Foreign Investment Law provides for the right of a foreign investor established as a legal Romanian person to acquire real estate, including land, necessary to the carrying out of its activities. This right is reaffirmed in the Foreign Investment Ordinance passed in June 1997 (see Chapter II).

There are no formal special restrictions on foreign direct investment in any specific sectors, except for insurance where a foreign company wishing to establish a subsidiary is required to associate itself with a Romanian partner. Authorisation for establishment in the other financial sectors is in principle granted on non-discriminatory and prudential conditions. The 1991 Foreign Investment Law specifically required foreign investments not to affect national security and defence interests and not to harm public order, public health and ethics. These requirements are not included in the June 1997 ordinance.

Foreign investors' participation in privatisation programmes is in principle permitted on a National Treatment basis, and occasionally encouraged by means of special tranches of issues on international markets or direct solicitation of foreign major investors, such as investment banks. Concessions are also granted on National Treatment conditions.

There are no compulsory performance requirements. Special tax incentives such as temporary reductions in the tax rate applicable to profits and certain customs duties exemptions are granted to foreign investments, depending on the size of the initial investment, the share of foreign equity participation, and/or certain other conditions – for instance in respect of export performance, employment creation or technology transfers (see below). In the opinion of the Romanian authorities, the introduction of special tax incentives is justified partly in view of the higher corporate tax rate in Romania compared with those prevailing in other countries in the region which compete to attract foreign direct investment.

In spite of this open regulatory regime, incentives and the attraction of low labour costs and a large domestic market, until early 1997 Romania received a much lower amount of foreign direct investment both in terms of percentage of GDP and per capita compared with other central and eastern European countries. According to the Romanian Development Agency, FDI between 1991 and end-1996 totalled only US$2.1 billion. Several factors explain this modest performance. Privatisation has proceeded slowly, in particular in sectors such as public utilities and finance, so that the scope for large participation of foreign investors in the economy has remained limited in practice. Macroeconomic instability discouraged long-term foreign investment and the lack of efficient infrastructure has also been a matter of concern for foreign investors. Finally, establishing an enterprise is a lengthy and cumbersome process, whether for foreign investors or for domestic investors, due to bureaucratic delays and complications at the many administrative steps to be undertaken to establish an enterprise in Romania. A positive sign is that the present government is committed to combat corruption and has sought co-operation in this respect with the OECD.

During 1997, FDI has picked up, with inflows of US$1.3 billion between April and end-October. At the latter date, the top five countries by investment volume were France, Korea, the Netherlands, Germany and USA, while Italy and Germany were the leaders in terms of the number of investors. The sectors attracting the highest amounts of capital were automobile manufacturing, telecommunications, construction materials and chemicals.

The special FDI incentives

The new Romanian foreign investment ''emergency ordinance'' passed in June 1997 contains key provisions concerning FDI incentives:

– Investments of US$350 000 or more, representing at least 20 per cent of a company's initial capital, will receive favourable tax and customs treatment over a two-year period. Specifically, they are subject to lower profit taxes (15 per cent versus 38 per cent), a 50 per cent reduction in customs duties, and customs exemptions for property imported and contributed in kind;
– investments of over US$5 million have similar incentives over a five-year period if the commercial project meets additional criteria, including the annual reinvestment of 50 per cent of profits. The extended incentives are aimed at promoting investments in infrastructure, tourism, export production, environmental projects, and projects located in special high technology economic zones;
– companies purchased from the state ownership fund (SOF) for over US$1 million also benefit from incentives if they commit themselves to restructuring, modernisation, job creation, technology transfer, profitability, local content requirements, environmental protection, and export promotion. In return, investors can benefit from reduced profit taxes for five years, and 8-year exemptions from customs duties and VAT for equipment and installation.

These special incentives have raised a policy debate in Romania. While such provisions may find a justification in the transitional stage of the economy and the need for rapid catch-up of the time lost in the past in pursuing more hesitant policies in the structural areas, it is clear that such advantages will need to be phased out in time. The Council for Reform is preparing a new piece of legislation to establish equal treatment between foreign and domestic investors. Fundamentally, the competition for attracting foreign investment depends on sound macroeconomic policy and large scale restructuring. These are the most important conditions for receiving long-term capital inflows necessary for the recovery and further growth.

IV. Labour market and social policies

Introduction

Despite the slow pace of economic restructuring, there were significant declines in employment and real incomes in the early years of transition: between 1990 and mid-1994, approximately one-third of the jobs in industry were lost; real wages declined by 40 per cent; and the real income of households fell by more than one-fifth. Moreover, for those redundant industrial workers who, as a temporary solution, moved to self-employment in the agricultural sector, the income reductions in most cases were probably larger than the wage losses experienced by workers who kept their jobs.

Some signs of more sustainable output expansion have begun to emerge in the relatively small private service and manufacturing sectors. The conditions for growth in these areas are favourable: ample supplies of well-educated workers in search of better jobs, low wages, decentralised wage-setting, and liberal employment protection regulations. Nevertheless, the job-creation potential in these sectors has been slow to emerge, reflecting the adverse impact of several economic factors including low domestic purchasing power and weak export growth.

As accelerated restructuring proceeds, some increase in unemployment over its level of the early autumn 1997 (about 7 per cent) is likely to occur. This potential development, coupled with the hardship which now affects broad segments of the Romanian population, suggests that the main objectives for labour market and social policies must be not only to facilitate necessary restructuring, but also to cushion the most severe negative effects in order to help sustain the momentum for change.

This chapter outlines the current labour market and social problems in Romania, particularly with respect to the potential short-term social consequences of accelerated enterprise restructuring, and examines the capacity of existing policies and institutions to respond to them.

The Social Context: Living Standards in Romania

The level and distribution of household income

The trend in household welfare during the transition years mirrors the path of GDP: real GDP declined sharply between 1990 and 1994; modest growth occurred between 1994 and 1996, although it remained below its 1990 level; there was then a renewed decline in real GDP during 1997. Average household income was estimated to have declined by 21 per cent in 1994 relative to its 1989 level, and household consumption by even more (29 per cent), largely because of the falls in GDP (World Bank, 1997).[51] While average household income grew by nearly 5 per cent between 1995 and 1996, this was due to an increase in imputed income from household plots rather than an increase in money income. Moreover, this increase was concentrated among higher-income households (NCS, 1997).[52]

Virtually all households were affected by declines in real income, but not equally. Income inequality increased in the first half of the 1990s, but then declined slightly by 1996 (Table 19). The value of transfer payments generally declined more than wages (see below).

Poverty

Economic hardship existed prior to 1990, but it seems undeniable that it was exacerbated during the early years of the transition. There is as yet no official definition of the concept of ‘‘poverty’’, but several unofficial measures suggest that its incidence may have peaked around 1994-1995, and then declined mod-

Table 19. **Income inequality**

	1989	1993	1994	1996
Gini coefficient	0.23	0.28	0.30	0.28

Source: World Bank, 1997; Secretariat calculations.

estly by 1996. Table 20 shows estimates of poverty relative to mean household consumption expenditure,[53] but adjustments for differences in family size and composition are based on four different equivalence scales (see notes, Table 20.) It therefore should not be surprising that the estimates of the overall poverty head count also differ: they ranged from 10 per cent to 14 per cent in 1996. (Estimates reported elsewhere have suggested that from one-third to more than one-half of the population suffers moderate to severe deprivation, UNDP, 1997).

If enterprise restructuring proceeds at an accelerated pace and this leads to increased unemployment in the short-term, it is likely that a larger share of the population will experience poverty before sustained economic growth can reduce it on a more permanent basis.

Who are the poor?

The highest incidence of poverty in 1996 was reported for members of households whose heads were unemployed or of working age but not in the labour force, mostly due to disability or home responsibilities. Relatively high poverty rates were also found in the households of farmers and other self-employed persons (Table 20, first column for each equivalence scale). Households headed by employees, and – by some estimates – pensioners, had below-average poverty rates. Employers were found to have the lowest rates.

Poverty was more prevalent in female than male-headed households according to almost all estimates.[54] It appeared to increase with household size, except in one estimate.[55] Poverty rates unambiguously declined with increased levels of educational attainment. There is also a regional dimension: the north-east region had the highest rate, while Bucharest had the lowest.

A different perspective emerges if one considers the contribution of each group to the total population of the poor (Table 20, second column for each equivalence scale). Households headed by employees and pensioners – the two largest groups in the population – account for about 60 per cent of the persons in poverty, despite their below-average poverty rates by most estimates.[56] Individuals in farm households were the third largest group in poverty, accounting for double the number in households with an unemployed head in 1996. Obviously, both the absolute numbers and the relative incidence of poverty within a group can be relevant for policy decisions.

Table 20. **Incidence and distribution of poverty[1] in 1996 by the occupational status of household heads**

Adult equivalence scale

Occupational status of the household head	Romanian (new)[2]		Romanian (old)[3]		Per Capita[4]		OECD[5]	
	Incidence of poverty	Distribution of poor persons	Incidence of poverty	Distribution of poor persons	Incidence of poverty	Distribution of poor persons	Incidence of poverty	Distribution of poor persons
All categories/ Total								
1994[6]	n.a.	100	15.7	100	19.2	100	12.6	100
1995[7]	14	100	n.a.	100	16	100	12.4	100
1996[8]	13.8	100	11.8	100	13.7	100	10.4	100
Employee	11	36	8	29	10	34	5	22
Employer	1	–	1	–	2	–	1	–
Self-employed, non-agricultural	29	6	25	6	29	6	21	6
Farmer	29	20	25	21	29	20	21	20
Unemployed	36	10	30	10	37	10	25	9
Pensioner	9	24	10	31	10	26	11	39
Other not in the labour force	34	3	32	4	36	3	32	4

1. ''Poor'' persons = members of households with less than 50 per cent of the mean household consumption expenditure per ''person equivalent'', as defined by alternative methods (adult equivalence scales). Incidence of poverty: Members of poor households as a per cent of the members of all households in an occupational category. Distribution of poor persons: Members of poor households in an occupational category as a per cent of all poor persons.
2. The new Romanian equivalence scale is based on recommendations from Romanian nutritionists. It gives the following weights to household members: 0.28 to child aged 0-1 years; 0.36 to child aged 2-3 years; 0.47 to child aged 4-6 years; 0.58 to child aged 7-9 years, male over 65 years and female over 56 years; 0.69 to child aged 10-12 years; 0.78 to girls aged 13-20 years; 0.86 to boys aged 13-15 years; 1.00 to boys aged 16-20 years; 0.97 to male adult aged 21-65 years, and 0.81 to female adult aged 21-56 years.
3. The old Romanian equivalence scale uses the following weights: 1.00 for first adult person; 0.8 for each additional adult person; 0.6 for each child aged 7-14 years, and 0.4 for each child aged 0-6 years.
4. Each individual in the household receives a weight of 1.0.
5. The OECD equivalent scale assigns the following weights to the members: 1.00 for the first adult (18 years and over), household head; 0.5 for additional adults (18 years and over), and 0.3 for each child (younger than 18 years).
6. Calculations by the World Bank.
7. Calculations by National Commission for Statistics.
8. Calculation by the Secretariat.

Source: Integrated household survey of Romania; World Bank, 1997; UNDP, 1997; Secretariat calculations.

Poverty clearly is widespread across household types. However, poverty which results from low wages and pensions is more prevalent than that caused by unemployment. This fact represents a strong argument for the government to promote rapid restructuring of the economy towards more efficient and profitable enterprises, which can pay higher wages and create more jobs. But such a strategy may do little to alleviate poverty among the inactive population, such as pensioners. Hence, public policy must also seek to relieve poverty for these groups.

The labour market

The labour force, employment and unemployment

Enterprise restructuring to improve the profitability of firms across the economy also increases the risk of dismissal for many workers in the short-term. The chance of limiting the hardship of workers and their families depends not only on the emergence of better jobs in the future and adequate transitional arrangements, but also on current conditions in the labour market.

Romania's labour force participation rate was 71 per cent of the 15 to 64 year-old population in 1996 , and the corresponding employment/population ratio was almost 66 per cent. Both of these ratios are above the OECD-Europe levels. Comparisons with other Central and Eastern European countries (see Table 21, which uses some country-specific definitions of working age) suggest that Romania's participation and employment rates are around the mid-range in this region.

Between 1990 and 1994, employment in the manufacturing and transport sectors declined by about one-third, increased in agriculture by 16 per cent, while total employment declined by about 8 per cent (Table 22).[57] The increase in farm employment was largely reversed in 1995, while thereafter no clear trend has emerged with respect to the proportions of agricultural or industrial employment. The agricultural share of total employment was still over one-third in 1995, according to the data source used in Table 22. According to 1996 data from labour force surveys (LFS), the agriculture share was 38 per cent including part-timers, compared with 27 per cent for industry, 4 per cent for construction and 31 per cent for services.[58] These proportions show a strong seasonal pattern: the

Table 21. **Labour force participation and employment rates in selected transition countries**

Percentage of the working-age population[1]

	Participation rate				Employment rate			
	1993	1994	1995	1996	1993	1994	1995	1996
Romania[2]	..	**72.7**	**73.6**	**73.3**	..	**65.9**	**66.8**	**67.6**
Male	..	**78.1**	**78.8**	**78.9**	..	**71.5**	**72.3**	**73.5**
Female	..	**66.8**	**67.8**	**67.2**	..	**59.9**	**60.8**	**61.3**
Bulgaria	75.2	73.1	71.4	71.3	59.0	58.2	59.5	61.1
Czech Republic	79.7	79.7	76.9	76.9	76.8	76.8	74.0	74.2
Hungary	69.2	69.2	65.7	65.1	61.0	61.0	58.8	58.6
Poland	71.1	71.2	69.4	68.8	60.1	60.4	59.8	60.0
Russia	77.6	76.9	77.6	76.4	73.2	70.7	70.3	69.0
Slovakia	74.5	74.5	75.0	76.2	64.6	64.6	65.1	67.9
Slovenia	77.3	77.5	69.5	68.1	70.1	70.3	64.3	63.0

Note: All LFS data are annual averages except as noted: Romania Q1 1994 and 1995; Bulgaria Q3 1993, Q2, Q4 1994 and Q1-Q3 1995; Slovenia Q2 of each year; Russia Q4 of 1993, 1994 and 1995, Q1 1996.
.. Data series are not available.
1. Defined to include women aged 15 to 54 and men 15 to 59, except in Poland where the data cover women aged 15 to 59 and men aged 15 to 64, and in Romania which include women aged 15 to 56 and men aged 15 to 61.
2. For population aged 15-64, participation rate for Romania in 1996 was 70.6 (male: 77.9, female: 63.5), and employment rate was 65.5 (male: 72.6, female: 58.4).
Source: OECD-CCET Labour Market database.

Table 22. **Employment by sector of economic activity**

	1990	1991	1992	1993	1994	1995	1996
	Thousands	1990 = 100					
Agriculture	3 144	101.9	109.5	114.9	116.0	103.8	105.6
Mining	259	106.9	105.0	100.0	98.8	96.5	96.5
Manufacturing	3 613	93.3	79.3	72.1	68.0	63.5	63.7
Electricity, gas and water	133	115.8	123.3	124.1	127.8	128.6	142.1
Construction	706	71.0	82.0	81.3	79.7	67.8	67.3
Trade	538	129.9	140.1	108.7	118.2	160.8	143.5
Hotels and restaurants	186	114.5	94.1	70.4	73.1	66.1	62.4
Transport	667	89.1	83.4	74.5	69.3	68.7	67.2
Post and communications	97	99.0	95.9	97.9	96.9	101.0	102.1
Financial services and real estate	427	108.9	116.6	113.1	116.4	92.5	76.8
Public administration	88	112.5	128.4	133.0	142.0	148.9	142.0
Education	411	103.6	105.1	105.1	106.3	106.3	107.3
Health	320	97.2	95.6	96.3	104.1	104.1	105.3
Other	251	149.0	82.9	78.1	79.3	77.7	70.5
Total	10 840	99.5	96.5	92.8	92.4	87.6	86.5

Source: *Romanian Statistical Yearbook*, 1996, based on the ''labour force balance'' (see footnote in the text).

agricultural share of employment rises from below 33 per cent in the first quarter of 1996 to above 40 per cent in the second and third quarters, balanced by roughly equal falls of three to four percentage points in the shares of industry and services.

The service sector's share of total employment (31 per cent in 1996) is lower than in most comparable countries. There has been little or no growth in service employment for most of the 1990s, but a positive trend emerged after 1994, mainly in wholesale and retail trade, financial and related services, and in public administration. Non-farm self-employment is not highly developed: it accounted for only 4 per cent of total employment in 1996 according to LFS estimates.

Registered unemployment peaked at approximately 11 per cent of the labour force in 1994 and early 1995, after which it fell to an average of slightly under 7 per cent (about 800 000 persons) during 1996. Almost the same figure, or 6.7 per cent, was reported using LFS data (see below). About one-half of the LFS-unemployed in the first quarter of 1997 had been out of work for a year or more, while over one quarter had been so for over two years. Official estimates have indicated that an increase in unemployment to about 9-10 per cent is expected by the end of 1997.

Underemployment, discouraged workers and ''hidden'' unemployment

The similarity of unemployment rates using administrative and LFS data for 1996 is a coincidence explained by compositional differences. Neither measure captures the full extent of underemployment, although for different reasons. First, many persons classified as unemployed by the LFS do not sign on in employment offices, perhaps because their benefit entitlements are small or non-existent (see Table 23, which refers to the first quarter 1997). Second, over one-fifth of the registered unemployed actually work, but want to change jobs – a situation by far most common in rural areas. Apparently, the reason is often that they work less than the number of hours per week they would like. An equally large group, but predominantly urban, are registered as unemployed but do not seek jobs, and so are not in the labour force by the ILO definitions used in the LFS. Many of them are ''discouraged workers''.

However, most persons in such situations are not registered at employment offices. Altogether – according to the LFS in the first quarter 1997 – some 2.5 per

Table 23. **The labour market status of persons registered as unemployed, Q1 1997**

Per cent of the labour force

	Registered as unemployed		Not registered as unemployed	Total
	with benefits	without benefits		
Total economy				
LFS Unemployed	**2.2**	**1.0**	**3.5**	**6.7**
LFS Employed	**0.9**	**0.6**	**..**	**..**
Seek other jobs and are available	0.5	0.3	1.8	2.6
Don't seek other jobs, but are available	0.2	0.1	6.1	6.4
Not available for other jobs	0.2	0.1	..	..
LFS Inactive[1]	**0.9**	**0.3**	**..**	**..**
Don't seek jobs, but are available[2] (''discouraged workers'')	0.5	0.2	3.4	4.1
Not available	0.4	0.1	..	..
Total	**4.1**	**1.9**	**..**	**..**
Urban areas				
LFS Unemployed	**2.9**	**1.3**	**4.0**	**8.3**
LFS Employed	**0.3**	**0.2**	**..**	**..**
Seek other jobs and are available	0.1	0.1	1.3	1.5
Don't seek other jobs, but are available	0.1	0.1	5.2	5.3
Not available for other jobs	0.1	0.1	..	..
LFS Inactive	**1.3**	**0.4**	**..**	**..**
Don't seek jobs, but are available (''discouraged workers'')	0.7	0.3	2.8	3.8
Not available	0.6	0.1	..	..
Total	**4.5**	**2.0**	**..**	**..**
Rural areas				
LFS Unemployed	**1.5**	**0.6**	**3.0**	**5.0**
LFS Employed	**1.5**	**1.0**	**..**	**..**
Seek other jobs and are available	0.9	0.6	2.3	3.8
Don't seek other jobs, but are available	0.3	0.2	7.0	7.5
Not available for other jobs	0.3	0.2	..	..
LFS Inactive	**0.6**	**0.2**	**..**	**..**
Don't seek jobs, but are available (''discouraged workers'')	0.3	0.1	4.0	4.5
Not available	0.3	0.1	..	..
Total	**3.6**	**1.8**	**..**	**..**

1. Because the labour force is defined as the sum of employment and unemployment, inactive persons are not part of the denominators used for percentage calculation.
2. Including ''discouraged workers'', who are available for work immediately (in total, 2.8 per cent of the labour force) and others who are available only under certain conditions.

Source: LFS (''AMIGO'') quoted from Informatie Statistice Operative, Trim. I 1997.

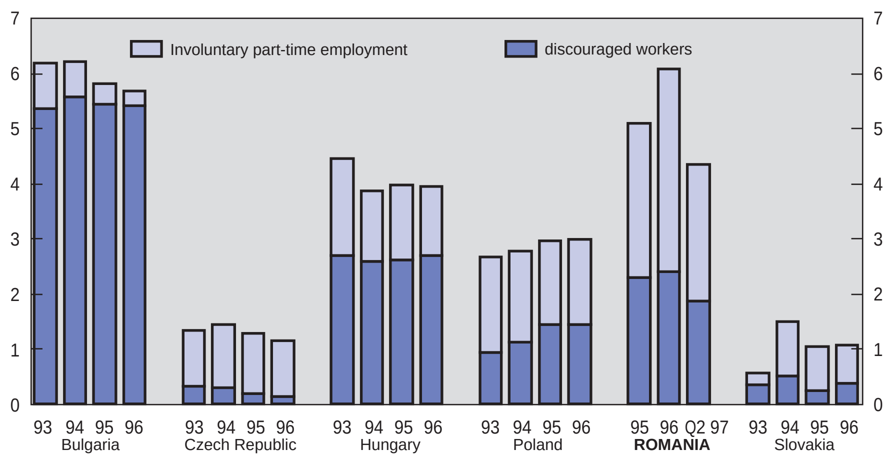
cent of the labour force, of whom four-fifths were in rural areas, had shorter working hours than they wanted; most of them were also in the group deemed to be available for other jobs. At the same time, the number of ''discouraged workers'' was nearly 3 per cent of the labour force. Both these figures are relatively high by international standards (Figure 23).[59]

More troubling from a policy perspective, however – and more difficult to estimate – is the extent of unemployment that is ''hidden'' in low-productivity work. The possible size of this group can only be roughly indicated based on information about the economic structure and prospects of various sectors of the Romanian economy, especially farming and industry.

Persons working on farms are predominantly self-employed, and, on average, have only a few hectares of land, often cultivated in part or entirely on a subsistence basis. Many are part-time workers, voluntarily or not, but a majority report normal working hours.[60] Living standards are often lower than average, but large farms can generate relatively high incomes: inequality is greater in rural than in urban areas. In 1996, around 20 to 30 per cent of the agricultural

Figure 23. **DISCOURAGED WORKERS AND INVOLUNTARY PART-TIME EMPLOYMENT**

Percentage of labour force



Source: OECD-CCET Labour Market database.

population fell below the poverty line, depending on the poverty measure used (Table 20).

In industry, many enterprises are unprofitable (see chapter III) but it is impossible to estimate with any precision the number of jobs that will ultimately have to be sacrificed or the potential speed of labour-shedding. About 70 to 75 per cent of all corporate losses were concentrated in about 20 public utilities and about 50 other enterprises in 1996, which employ approximately 600 000 workers or one-tenth of the total non-farm employment. At least 100 000 jobs in these enterprises alone might be eliminated within a few years. The figure could become substantially higher if many of the worksites are closed. In addition, labour shedding might increase in other enterprises as a result of the accelerated privatisation since Spring 1997.

Wages and the income distribution

Real wages fell more and remained low for a longer time in Romania than in most of Central and Eastern Europe. In June 1997, the average net real wage in Romania was only 50 per cent of the level in October 1990, but it recovered to 56 per cent of the same benchmark by September 1997.[61] A previous low of 52 per cent, attained in early 1994, had been followed by two years of increase and a renewed strong decline at the beginning of 1997 (Figure 13 and Table 24).

Table 24. **Average gross monthly wages in selected transition countries, 1994-96**

	Wages compared at current exchange rates						Wages compared at PPPs					
	US dollars per month			Romania = 100			US dollars per month			Romania = 100		
	1994	1995	1996	1994	1995	1996	1994	1995	1996	1994	1995	1996
Romania	**86**	**104**	**104**	**100**	**100**	**100**	**255**	**285**	**305**	**100**	**100**	**100**
Germany	2 406	2 817	2 739	2 804	2 709	2 623	1 887	1 950	2 011	740	684	659
Czech Republic	240	308	336	280	296	322	615	670	598	241	235	196
Slovakia	192	240	268	224	231	257	501	545	605	197	191	198
Poland	241	300	331	280	288	317	502	538	518	197	189	170
Hungary	317	310	307	369	298	294	494	477	464	194	167	152
Bulgaria	86	111	69	100	107	66	342	350	280	134	123	92
Russia	110	117	164	128	112	157	439	354	391	172	124	128

Source: Short-term Economic Indicators database; Main Economic Indicators database; OECD Analytical Database.

In nominal terms, the average monthly wage in September 1997 was about 934 000 lei before-tax and 710 000 lei after-tax – that is, about US$120 and US$90, respectively, or about three times as much in terms of purchasing power.

Wage bargaining is generally decentralised and not subject to direct intervention by the government, apart from the public administration and *Régies Autonomes* where the government has the final authority (see Box 6). A legal minimum wage exists and was fixed at 250 000 lei per month in October 1997. Almost all employees earn more than the legal minimum since it is so low relative to average wages. It serves primarily as a benchmark for social transfers, and as a lower limit for taxable income.

Wage differentials are substantial and growing, especially in privately owned enterprises. Formal education is a major criterion for wage differentiation, as in many transition countries, but other individual factors are probably becoming more important. The highest sectoral average wages (in banking) are over three times as high as the lowest ones (in agriculture and tourism) (Table 25). Wages are also lower than average in trade, public administration, health care, education and some light manufacturing sectors. Significantly, wages are relatively high in several sectors suffering from difficult structural problems. They have even increased since 1990 in the energy-intensive metallurgy and chemicals industries; in contrast, they have begun to decline from high levels in the mining, petroleum, gas extraction and energy sectors. Important employers in these sectors are *Régies Autonomes*, upon which the government has imposed a more restrictive wage policy during 1997.

Labour-market conditions in expanding sectors

The growth of new economic activities has not yet been very strong. Recent trends in employment, output and investment (see Table 22 and Chapter III) suggest that the prospects may be especially promising in industries that produce light consumer goods such as clothing, furniture and some types of electrical equipment, as well as in trade, tourism and other private services. In these areas, there is large potential for domestic market growth. In the short term, however, it will be particularly important for many enterprises to improve their international activity and competitiveness. Not only do they need the additional revenue that

Box 6. **Wage setting**

Wage bargaining usually takes place at the enterprise level, with a central collective agreement as a framework. It is not heavily influenced by public policy intervention, apart from general regulations in law.[1] As a rule, employers with more than 20 employees must initiate negotiations with a trade union, provided that the latter is representative according to certain criteria.[2] But in public administrations and *Régies Autonomes,* wages are determined by the government in consultation with trade unions. The unions are well represented in most state-owned enterprises and *Régies Autonomes,* while their position is often weak in new firms in the private sector. Nation-wide membership statistics for trade unions do not exist.

Collective agreements must run for at least a year. However, during 1997, the government applies a *quarterly indexation* of wages in the public administration (the ''budget sector''), corresponding to 75 per cent of the increase in consumer prices. This procedure, applied after consultation of trade unions, also serves as a recommendation for other employers.[3]

In general, the government has not considered recent wage developments in the private sector as excessive, while it has judged them as out-of-line with productivity in state-owned firms, especially *Régies Autonomes*. The *Régies* therefore were placed under special supervision during 1997; their wage-bill increases are subjected to special limits which are lower than 75 per cent of the consumer-price increase, depending on the size of the losses in each *Régie*. (A previous *tax-based incomes policy* for state-owned enterprises, with a payroll tax triggered by wage increases above certain limits, was abandoned in 1995.)

Usually, the collective bargaining partners at the local level will determine an enterprise-specific minimum wage which must be at least as high as the legal minimum wage, and a set of qualification coefficients, for which the national agreement stipulates certain floor values. National minimum coefficients (*e.g.* 1.2 for skilled manual jobs and 1.5 for jobs requiring university education) have little importance since, in practice, wage differentiation is greater. The basic wage for a particular job is obtained by multiplying the enterprise's minimum wage by the local coefficient for the relevant job category. In addition, a system of ''bonuses'' is traditionally used to obtain flexibility at a local level – a feature which may have become less useful after the recent reforms which provide such flexibility in any case.

1. The regulatory framework for collective bargaining is found, *inter alia,* in the Law on remuneration (No. 14, 1991) and the Law on collective agreements (No. 130, 1996). A nation-wide collective agreement by the Chamber of Commerce and Industry of Romania and five trade union confederations, as applicable in 1996, stipulated a maximum of 40 hours of work per week, at least 21 working days of paid holiday and a list of minimum coefficients for wage differentiation. Some of these rules have subsequently become compulsory by law (No. 130/96 and 147/97).

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(continued)

2. Recent legislation proposed by the government will, if adopted, give a right to collective bargaining for any trade union that represents one quarter of all workers in an enterprise or belongs to a confederation that has been declared representative at a national level.
3. Law No. 14, 1991, article 6.

Table 25. **Wage differentiation by industry, after tax**

National average of monthly wage earnings = 100

	1990	1993	1994	1995	1996	Aug. 97	Change 1990-97
Industry:							
Extraction	131	166	165	159	152	153	22
Food industry	90	99	97	99	101	101	11
Textile	88	73	71	71	74	73	–15
Apparel	83	75	74	74	73	85	2
Wood	80	85	78	81	82	73	–7
Chemicals	105	113	111	121	123	121	16
Metals	111	121	123	130	134	144	33
Metal products	96	89	89	97	96	95	–1
Machinery	100	99	94	100	109	102	2
Electric machinery	98	92	93	101	106	102	4
Cars	104	106	105	117	125	112	8
Furniture	87	87	80	84	82	82	–5
Energy, water	117	163	161	150	147	150	33
Other sectors:							
Agriculture	106	82	80	81	79	74	–32
Construction	111	107	116	106	103	105	–6
Transport	111	120	117	120	124	126	15
Post, telecom.	89	110	115	126	120	138	49
Trade	87	88	87	80	78	80	–7
Hotels, restaurants	84	70	69	69	67	72	–12
Finance	94	143	165	184	205	237	143
Education	96	91	93	92	86	68	–28
Health, social care	96	92	89	76	72	77	–19
Public administration	112	105	106	107	95	87	–25
Total	**100**	**100**	**100**	**100**	**100**	**100**	
Industry	*99*	*104*	*104*	*108*	*107*	*109*	*10*

Source: *Statistical Yearbook 1995, Buletin Statistic Lunar No. 8, 1997;* Ministry of Labour and Social Affairs; *Buletin Statistic al Industriei No. 8/97.*

exports can generate, but they stand to benefit from the stronger impetus to innovation and human-capital development that is associated with a presence in international markets.

Job creation has apparently not been constrained by skill shortages, as indicated by the relative absence of upward wage pressures in sectors with increasing employment. Indeed, as seen in Table 25, relative wages have been stagnant or falling in most of the growth sectors identified above. Relative wages also are below average in most of these sectors (except electricity, gas and water), reflecting the modest shares of skilled jobs in them.

The picture of wage moderation in sectors with job-creation potential is largely confirmed by Table 26, which compares private and state-owned firms in 1996. In the majority of industries, private employers paid less on average than their state-owned competitors. Data for the manufacturing sector suggest that this

Table 26. **Wage differentiation between private and public sectors**

Mean private sector wages as a per cent of the corresponding mean values in the public sector, 1996.

	Public sector wages = 100
Industries	
Agriculture	96
Extractive industries	52
Manufacturing	84
Power, gas, water	66
Construction	99
Trade and tourism	78
Transport, communications	87
Finance	82
Real estate	132
Education	77
Health care	80
Social services	88
Main occupational groups in the manufacturing sector	
Managers, intellectual occupations	94
Technicians, clerical staff	102
Manual jobs:	
Machine tool operators, etc.	89
Other specialised workers	83
Unskilled workers	87

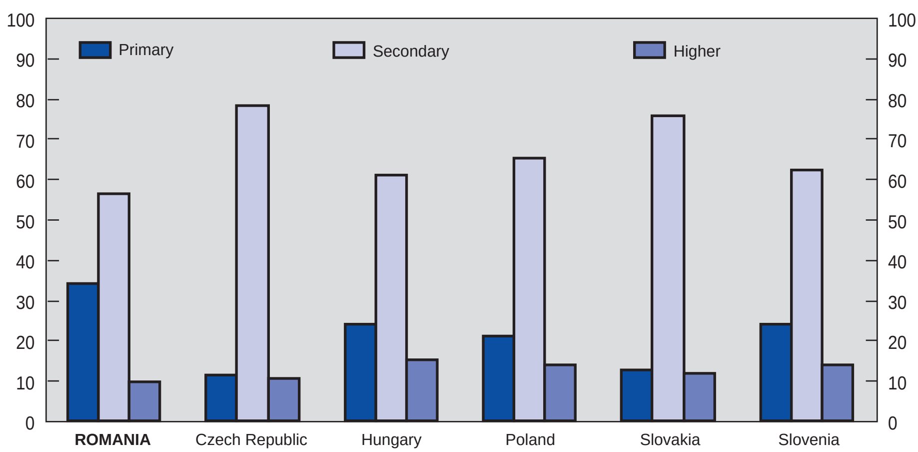
Note: Values over 100 indicate a wage premium in the private sector.
Source: For industries: Yearly survey on wages in enterprises. For occupations in the manufacturing sector: Integrated household survey.

difference primarily concerns manual workers: the type of ownership may have less impact on wages for white-collar workers.[62]

In Romania, as in other transition countries, the emergence of a private sector creates opportunities for substantially higher pay for some groups with relatively good qualifications *e.g.* in banking, health care and education. Nevertheless, the fact that the public administration has been able to increase its employment by almost one-half since 1990 while reducing its relative wages suggests that labour supply has been abundant, even in many qualified occupations.

The *educational attainment* of the labour force is broadly similar to the situation in other Central and Eastern European countries. Although Romania has a higher proportion with primary education or less, and a somewhat smaller proportion with higher education, compared with the countries shown in Figure 24, this comparator group stands out as having amongst the highest levels of educational attainment in the region as a whole. Education levels in Romania may not represent a labour-market problem at the moment, given the existing

Figure 24. **EDUCATIONAL ATTAINMENT, 1996**
Percentage distribution of the labour force



Source: OECD-CCET Labour Market database.

patterns of economic specialisation. In the long run, however, many employed workers are likely to need new skills as technology and market conditions evolve. Upgrading of job skills often is best achieved in a gradual manner, relying, for example, on short specialised courses that may be used recurrently by adults on temporary leave from their jobs. It should rely mainly on private initiative, as in most OECD countries, but some public co-ordination and additional support may be justified to ensure that the courses provided are sufficiently broad-based and relevant to groups of workers of particular policy concern.

The social protection system and social spending

Public income-transfer programmes are in place for most contingencies usually covered by social security in OECD countries, including old age, disability, sickness, child rearing, unemployment and low income.[63] Benefits are modest or low relative to average wages (see Annex V). Some benefits have been only partly indexed to consumer prices during the 1990s, leading to reductions in their real value over time. Since real wages also eroded in value, declining ratios of benefits to average wages – *i.e.* a fall in the effective replacement rates – indicates that the real value of benefits declined by even more than did wages.

Total social spending is expected to reach nearly 14 per cent of GDP in 1997, of which slightly more than 10 percentage points represent direct income transfers to households (Table 27). This reflects an increase in transfer spending by over two percentage points over the previous year. Nevertheless, the social spending appears relatively low compared with most OECD and transition countries.

More than one-half of the growth in spending on transfers to households during 1997 is due to an increase in the child allowance (50 000 lei per child per month since the Spring 1997) and the re-introduction of additional benefits for families with two or more children. The new severance compensation programme, a temporary bread subsidy paid during part of 1997 and the doubling of transfers to municipalities for social assistance and related measures account for the rest of the increase.

The increase in child allowances during 1997 was intended to ameliorate growing hardship in large families. However, child allowances are received by

Table 27. **Public expenditure on social policies as a percentage of GDP**

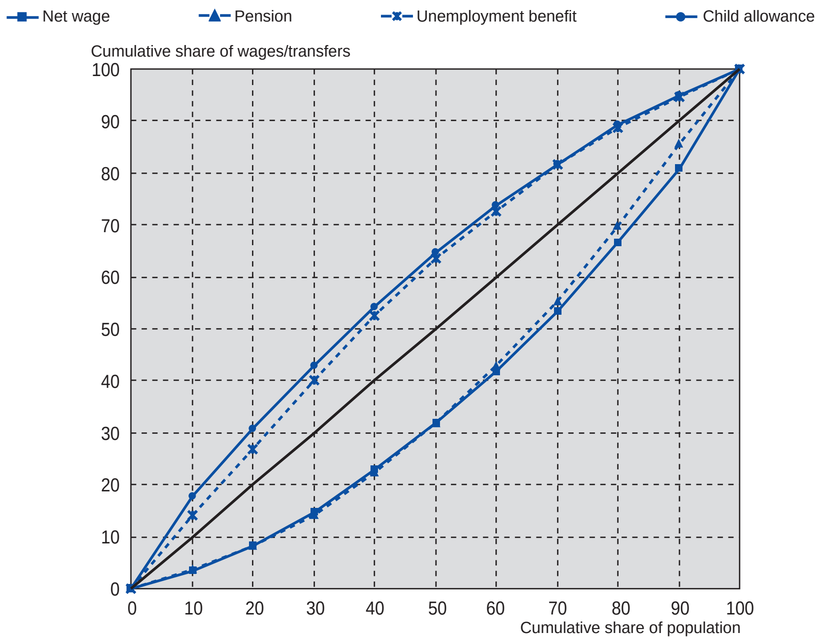
	1990	1991	1992	1993	1994	1995	1996	1997 budget
Pensions[1]	7.15	6.27	6.28	6.22	6.29	6.65	6.41	6.53
Other general income transfers	..	2.37	1.58	1.24	1.16	1.03	0.88	2.36
Child allowance	2.04	1.19	0.87	0.78	0.73	0.68	0.59	1.52
Additional support for multiple-child families	0.58	0.23	0.09	0.03	0.01	0.01	<>	0.20
Maternity leave and birth grants	..	0.42	0.31	0.22	0.16	0.14	0.14	0.14
Sickness benefits	..	0.53	0.32	0.22	0.18	0.17	0.15	0.15
Heating allowance	<>	<>	<>	<>	0.08	0.03	<>	0.05
Bread subsidy	<>	<>	<>	<>	<>	<>	<>	0.35
Labour market programmes	<>	0.30	0.72	0.86	0.89	0.93	0.65	1.17
Unemployment compensation	<>	0.29	0.71	0.85	0.88	0.79	0.57	0.62
Labour re-deployment programme (severance pay)	<>	<>	<>	<>	<>	<>	<>	0.45
Active labour market programmes	<>	0.01	0.01	0.01	0.01	0.15	0.08	0.10
Health care	2.74	3.20	3.15	2.81	3.00	2.91	2.82	2.99
Municipal social programmes[2]	0.01	0.06	0.05	0.15	0.16	0.27	0.28	0.59
Social assistance benefits (cash)	<>	0.03	0.03	0.02	0.01	0.11	0.15	0.29
Social canteens	0.01	0.01	0.01	0.02	0.03	0.03	0.03	0.06
Other (mainly in-kind services)[3]	<>	0.01	0.01	0.11	0.12	0.13	0.10	0.20
Total (excluding administration)	**..**	**12.20**	**11.78**	**11.28**	**11.50**	**11.80**	**11.03**	**13.65**
of which:								
Income transfers to households[4]	..	8.97	8.61	8.33	8.34	8.57	8.01	10.26

<> Nil.
.. Data not available.
1. Pensions from Romania's general social insurance, farmers' pensions, supplementary pensions, ''social'' pensions and military pensions. The general social insurance covers old-age, disability and survivor pensions.
2. Currently covered by a block grant from the State. The distribution between different items in 1997 is not known; in the table it was split up in the same proportions as in 1996.
3. From 1993, the largest municipal in-kind service items are homes for people with disabilities and the elderly. They were previously financed by the State, whose expenses for such measures are not included in the table. Even after 1993, some State bodies, such as the Risk Fund, carry certain expenditures of this nature in addition to those counted in the table.
4. Including all items except health care, active labour market programmes and the two last sub-categories of municipal social programmes. A small part of the labour re-deployment programme devoted to active labour market measures could not be distinguished, and is therefore included.

Source: The OECD Social Expenditure Data Base.

eligible households in all income brackets (see Figure 25).[64] This may have been appropriate as an emergency measure that could be implemented quickly and with relative administrative ease. For the future, however, programmes which are not restricted to families with children would appear preferable, to the extent that they can be administered with effective targeting of those most in need.

Figure 25. **DISTRIBUTION OF WAGES AND TRANSFERS, BY CONSUMPTION DECILES, 1996**



Source: Integrated Household Survey of Romania.

The trend in pension expenditures relative to GDP shows a decline of almost one percentage point between 1990 and 1991, with slight upward movement thereafter. The level of expenditures in 1997 of 6.5 per cent of GDP remained below the 1990 level of 7.2 per cent. There were two opposing trends over the period. First, the number of pensioners increased from 3.6 million in 1990 to 5.5 million in June 1997 (from approximately one-third to one-half of the number of employed persons; see Figure 12); this growth is attributable only in small part to the growth of the population over age 55, and is due mainly to the broadening of eligibility criteria for disability and retirement pensions (see below). Secondly, and most important, the real value of the average pension declined, mainly because the indexation was partial (Table 28). During 1997, the government permitted full indexation of farmers' pensions, which are extremely low, but other pensions continue to decline faster than wages in real terms.

Table 28. **Pensions as a per cent of the average after-tax wage**

Average for all months in each year

	1990	1991	1992	1993	1994	1995	1996	June 97
Pensions from the general social insurance								
Excluding supplementary pensions	47	45	43	45	43	42	39	42
For complete contribution periods	64	53	54	56	55	53	50	53
Disability pensions	42	40	37	39	36	34	32	33
Supplementary pensions	6	3	4	5	6	7	6	6
Farmers' pensions	14	7	5	6	9	8	8	11

Source: National Commission for Statistics: *Social statistics 1996*; Ministry of Labour and Social Protection: *Statistical Bulletin*, various issues.

Many workers retire at relatively low ages. Almost all workers can retire at age 55 (women) and 60 (men), although in theory the standard retirement age is two years higher. Moreover, an increasing number of occupational categories defined as having difficult working conditions, for example, construction and steel workers, are permitted to retire at earlier ages. The long-term unemployed who are within five years of the standard age of retirement are also eligible for retirement pensions. There are plans for a gradual increase of the standard pension age, to be phased in over a period of over 20 years, so that it would eventually reach 65 years for men and women. The special rules for certain occupational groups would then disappear (possibly with the exception of miners).

The disability programme also appears to have served as an unintended vehicle for early retirement. Although the increase in the absolute numbers of retirees is far larger, the population of disability beneficiaries grew faster than did the retiree population – it more than doubled between 1990 and 1997. This suggests a need for better administration and enforcement of the existing eligibility criteria; it may even be necessary to introduce more stringent rules of eligibility.

In general, early retirement via the pension system should be discouraged. For many middle-aged job losers, for example, temporary income support might be sufficient. For most groups, the option of early retirement is unlikely to be very attractive if suitable job options exist in the formal sector of the economy, given the relatively low levels of the pensions. On the other hand, however, there may be a risk that a combination of easy access to early retirement and low pensions can induce many to work in the ‘‘black’’ sector.

As a last resort, introduced in 1995, municipalities pay social assistance according to a national norm, with an estimated 400 000 beneficiary households in Spring 1997. Over one-half of them were single, mostly youth aged 18 to 26, for whom the standard amount was approximately one-sixth of the average wage after tax. Only the relatively few beneficiary households that included over 4 persons received more than half the average wage.

The institutional response to lay-offs

It is important that employers not be put under pressure to maintain employment or assume other social responsibilities at the expense of the long-term viability of their enterprises. However, even when such pressures are not explicitly applied, some employers may find it difficult to implement restructuring plans if the publicly financed social safety net is perceived as inadequate.

Romanian enterprises have shed much labour in recent years, but further restructuring and downsizing is needed. The government’s new labour redeployment programme for state-owned firms seeks to facilitate the process by offering severance pay to laid-off workers, a benefit that comes in addition to a number of other passive and active labour market programmes. This section reviews these policies, paying attention to the main instruments of relevance to redundant and unemployed workers: employment protection regulations, unemployment benefits and severance pay, and active labour market policies.

Employment protection

Employers in Romania face few formal restrictions in matters of hiring and firing: the current rules in the 1972 Labour Law and a national collective agreement are liberal by European standards. Thus, in principle, employers are free to decide about dismissals for economic reasons, having only to respect a notification period of one or two months and to consult trade unions before selecting the workers to dismiss. A new draft law about individual labour contracts, prepared in 1997, is not intended to alter the situation in this fundamental respect.[65]

In practice, however, decision making in state-owned enterprises is traditionally restrained to varying degrees by the supervisory roles played by Ministries, the State Ownership Fund and other bodies that may represent the state as owner. Much of the political supervision of enterprises has now been dismantled apart from the special case of the *Régies Autonomes;* but even the 1997 Emergency Ordinance– which covers all mass redundancies in state-owned companies and *Régies Autonomes* – stipulates that a restructuring plan must be approved by the above-mentioned State institutions before the enterprise managers can implement it.

When the Emergency Ordinance applies, the employers must also respect some further requirements concerning the selection of workers for dismissal. As a rule, they must first dismiss all workers who have more than one job and those who are eligible for pensions, and they are not allowed to hire new workers in the interim. If two spouses work in the same enterprise, only the one with the lower wage can be dismissed. Apart from these and a few other special limitations, however, even the state-owned enterprises can generally decide which workers they want to keep and which ones they want to lay off. It will be important to retain this principle in the future, so that employers can implement restructuring effectively.

Unemployment benefits and severance pay

Most unemployed persons in Romania receive low benefits or none at all, while only about one-third of them have recently received a wage-related compensation. The introduction of severance pay for a strictly defined group has increased this variation in benefit levels. The possible implications of this recent initiative for social equity, work incentives and other aspects are briefly considered below.

Persons who lose their jobs receive income-related unemployment benefits for up to nine months, provided that they have worked for six months in the last year. The benefits replace 50 to 60 per cent of the previous earnings, depending on length of service, up to a benefit ceiling equal to 55 per cent of the national average net wage.[66] Unemployed school leavers also receive benefits for up to nine months, amounting to 18 per cent of the average wage after secondary school and 20 per cent after higher education.

After the end of the nine-month period (with either kind of benefit), persons still unemployed can receive a flat-rate unemployment assistance benefit for the subsequent 18 months. This benefit amounts to 20 per cent of the average wage, subject to a means-test: the applicant's household must not have workable land or incomes exceeding a certain amount per capita.

Some 33 per cent of the about 720 000 registered unemployed in October 1997 were entitled to income-related benefits while 37 per cent received flat-rate benefits (including 10 per cent who recently completed education and 30 per cent with nine to 27 months of unemployment).[67] As many as 30 per cent of the unemployed received no benefit from the employment service, but some of them – or their households – received social assistance.

From mid-1997, most workers dismissed by state-owned enterprises are eligible to receive severance benefits for six, nine or twelve months depending on the length of service, plus three additional months if the local labour market situation is difficult.[68] These benefits, which can be combined with unemployment benefits, are equal to the estimated average wage in the relevant industry. Therefore, the total compensation paid to a laid-off worker in these enterprises is quite high, in typical cases amounting to more than one-and-a-half times the average wage during the first six or nine months of an unemployment spell. If a person receiving both types of benefit takes up work, only the unemployment benefit is withdrawn: severance benefits are still paid for the full period. Workers in the mining sector receive the severance benefit as a lump-sum; for other groups, this is possible only if the recipient shows proof of activity as self-employed. A budget adopted in 1997 implies paying severance benefits to approximately 200 000 workers.

Apart from the severance benefits, these provisions for compensation of the unemployed are broadly comparable to those in many transition countries and in the United States, but not as generous as a number of West European schemes. It should be noted that the long-term unemployed receive little compensation. The flat-rate benefit – corresponding to about $13 per month, or one-sixth of the average after-tax wage – is very low; it is approximately equal to the social-assistance benefit payable to a single person with no other income.

Job-search requirements

A condition for receipt of unemployment benefits (but not for severance pay) is that the recipients are available for work or vocational training. Such requirements can be difficult to enforce, as many OECD countries have found (see OECD 1996*a*). This might not be a reason for major concern in Romania at the moment, given the moderate level and duration of the benefits, but it could become an issue if the benefits are increased in the future. In general, the more generous a benefit system is, the more important it is to apply an appropriate set of conditions and controls; and, conversely, the more effectively these conditions and controls are applied, the more generous benefits can be without distorting unduly the labour supply or work incentive.

The public employment service has about 3 000 staff members, implying that there are between 150 and 200 benefit claimants per officer (counting all staff categories). Claimants must sign up once a month at a local office. The staff are expected to propose possible job matches or training to claimants, and can also apply sanctions if an offer is refused. However, due to resource constraints, most such activities beyond the simple signing-up are applied on a small scale: the budget for 1997 assumes that only about 150 000 job seekers will attend counselling interviews.

Unemployment benefits are frequently paid during *temporary lay-offs*, which can last for a full nine-month benefit period, during which the workers are formally employed but receive no wage. In such situations, when many expect to return to their previous jobs, a job-search requirement may not be possible to apply. Indeed, this use of the benefits may encourage both workers and employers to delay decisions which ultimately will be necessary. It would seem appropriate, therefore, to limit the compensation during temporary lay-offs to a period substantially shorter than nine months, and, perhaps, to apply penalties in case of repetition.[69]

Possible problems with severance pay

If a broader perspective is taken on Romania's public income-transfer policies, the relatively high planned spending on severance pay seems difficult to justify on grounds of social equity alone. However, the measure was motivated as an *emergency* measure, since the government is still a major employer over and above its role as the provider of social security.[70] Given this motivation, the programme in its present form should have short duration; its role in providing income support can subsequently, if necessary, be fulfilled within the general unemployment compensation programme which could be extended to incorporate some special provisions for mass-redundancy situations.

Given that the level of severance compensation is relatively generous, its existence can be expected to have substantial effects on labour-market behaviour. It is therefore crucial that its administration be effective and organised so as to change the behaviour of both employers and workers in the desired direction to speed up labour adjustments. In general, such effects can be difficult to achieve unless the administration of the programme is rapid and predictable. Otherwise, workers and employers may delay decisions about their future if they believe that this can increase their chances of obtaining public support.[71]

Judging from recent developments in the mining sector, a lump-sum payment is attractive to many workers, and therefore particularly effective in ''buying'' the acceptance of those being laid off. It also simplifies administration. However, when such a large lump-sum is combined with the right to draw unemployment benefits, there is a risk of distorting incentives to seek new jobs. The severance benefit in itself can be legitimately spent for any purpose, including those which may potentially delay the job search; but such delays are not compatible with the policy objectives of unemployment benefits.

An alternative solution could be to offer severance payments as an immediate lump-sum in all cases, and to pay unemployment benefits to these workers only after a waiting period (for example, this period could be around six months). Compared with the present rules, unemployment benefits would be better targeted on those who become long-term unemployed, while expenditures would be lower in the cases when recipients find work relatively quickly. In general, there is a trade-off between income security and the incentive to search actively for a new job. This suggests that access to income-related benefits should be of limited duration, and the income replacement rate should decline over time.

Active labour market policies (ALMPs)

The Emergency Ordinance also established a tripartite National Board for co-ordination of ALMPs. It primarily co-ordinates severance pay and other special measures for workers in the state sector, but soon may be transformed into an Agency in charge of the public employment service, which currently has

184 local offices. There are plans to increase the staffing of these offices to about 5 000.

The budget for 1997 has foreseen expenditures of about 0.1 per cent of GDP (222 billion lei) for ALMPs, including office costs (Table 27). A training subsidy is expected to benefit 82 000 workers, but projected expenditures per trainee are very low. Instead the dominant item in spending terms (80 billion lei) consists of low-interest loans to small and medium-sized enterprises, programmed to create only some 7 800 jobs for the unemployed. These loans are paid on condition that over 50 per cent of the hired workers were previously unemployed.

To encourage hiring of graduates from education, the government has decided in October 1997 to pay a subsidy amounting to 70 per cent of their net wage during 12 months, or 18 months in the case of disabled persons. The projected spending on this item in 1997 is 55 billion lei, suggesting a relatively low take-up (perhaps about 10 000 persons).

The budget for severance pay also can be used to finance active measures for recipients, following a bidding procedure which should encourage a market-based provision of such measures, or be paid as a lump-sum to start a firm.[72] Several international assistance projects play a role in financing development and implementation of ALMPs, including the World Bank, the European Union (PHARE)[73] and individual countries. Some of them concern employment-office infrastructure and technology *e.g.* for job matching, vocational guidance, statistics and monitoring, while others provide training, support of self-employment and small firms or community works. Many of these projects are small and decentralised.

In spite of the efforts made, ALMPs play a very small role in Romania. Spending on them in relation to GDP is lower than in almost any other transition country apart from Russia. Moreover, the available administrative resources are unlikely to permit more than a moderate increase in spending over the medium term. Regarding training of the unemployed, especially, evaluations made elsewhere have suggested that, when such programmes are implemented on a large scale, they have often become ineffective due to administrative difficulties and ill-defined targeting, even in countries whose employment-service administrations are much more well-resourced than the Romanian one.[74]

To the extent that the budget for active programmes can be increased in the future, the main priority should therefore be given to counselling and job-search assistance for benefit claimants, a type of measure that is comparatively cost-effective according to OECD experience. It should include a capacity for targeted job counselling for the workers of enterprises that declare mass redundancies. Some special emphasis on self-employment support may also appear justified in the Romanian context, given the potential for growth in the still under-developed sectors of small-scale services and manufacturing. In general, however – as international experience has shown – only a relatively small group among the unemployed are likely to be able to start up their own enterprises.

Notes

1. The draft of this report was discussed by delegates of OECD Member countries and a Romanian delegation in Paris on the 26 March 1993.

2. In June 1996, the local elections already witnessed a shift in popular support from the ruling coalition towards the opposition parties. The results of the parliamentary elections on 3 November 1996 confirmed this trend. The Democratic Convention of Romania (CDR) won the elections with 30.7 per cent of the votes. The (ruling) Party of Social Democracy in Romania (PDSR) was behind with 23.1 per cent. They were followed by Social Democratic Union (USD) with 13.2 per cent; the Hungarian Democratic Union of Romania with 6.8 per cent, the Greater Romania Party with 4.5 per cent, and, the Party of Romanian National Unity with 4.2 per cent of the votes. The coalition between the CDR and USD got the relative majority in the Parliament. The results of the second round of the presidential election on 17 November 1996 confirmed plainly the political overturn marked by 54 per cent of the votes going to Mr. Constantinescu against the incumbent Mr. Iliescu.

3. Speech of the Prime Minister at the Press conference of 17 February 1997.

4. The industrial output usually displays a setback in winter and recovery in spring. These figures are to be taken with particular caution because the size and extent of the shadow economy are poorly understood. The official figure for the shadow economy is around 20 per cent in 1996.

5. This adjustment was done in the following way. Rather than (in effect) assigning all imports to the export sector (as is done in looking at the net trade contribution), total imports were split into intermediate and investment goods, and final consumption products. The former were deducted from exports and the latter from domestic demand. The imports of intermediate and investment goods correspond to energy, raw-materials, base chemicals and specialised machinery. They correspond to approximately 65 per cent of total imports in 1995.

6. While Romania was affected, as were other countries in the region, by the impact of a slowdown of growth and demand in western markets, part of the export slowdown in 1996 may also be related to a statistical problem. Given the obligation to repatriate export revenues introduced after the exchange rate crisis of end-1995, firms had an incentive to under-report their export activity.

7. Part of this growth may be due to the accumulation of stocks but, for the moment, there are no sufficiently reliable data to check this point.

8. For private consumers with low usage (below 50 KWh a month) prices remained stable; for consumption between 50 and 100 KWh a month prices rose by 2.4 times and above that level prices increased nearly fivefold.
9. Including around 90 tonnes of monetary gold.
10. In 1996, the structure of employment in the agricultural sector was as follows: employees 10.7 per cent, employers 0.1 per cent, own-account workers 46.5 per cent, non-salaried family workers 41.4 per cent, other (*e.g.* co-operative members) 1.3 per cent (see Labour Force Survey-AMIGO, 1996).
11. The 1993 Assessment pointed out the important impact on overall public spending of several off-budget accounts, particularly the foreign assets revaluation fund, and the counterpart fund from foreign currency loans to the government (see OECD 1993, Table 13).
12. In particular, the International Monetary Fund has taken lead responsibility in working with the Romanian authorities on the macroeconomic stabilisation programme, while the World Bank has focused on structural reforms (especially in the areas of agriculture, industry, and social protection).
13. The employment reduction involved 114 000 posts and 75 000 people (as some posts were unfilled) by September 1997. Most of these cuts came in the Ministries of Health (linked with the contracting-out of cleaning and maintenance functions); education (stemming from demographic trends in which fewer primary teachers are required, plus some cuts in administration); and agriculture (including reductions from three to one in the number if Ministry-funded agricultural advisors assigned to each village).
14. Standard old-age pension replacement rates for those with full cover tend to be in the 40 to 60 per cent range in many OECD countries, although rates much higher and lower than these can also be found in some cases (*cf.* Roseveare *et al.,* 1996).
15. A striking provision in this regard concerns imported raw materials which are processed and then re-exported for sale abroad; such goods receive back the customs duties paid on entry. However, under this provision, sellers were required to re-export the products concerned through their *original* port of entry. In March 1997, this requirement was abolished by a government decision, reinforced by a new Customs Code adopted in September.
16. The leu deposits of households grew dramatically during 1994. The de- and remonetisation of the economy is illustrated by the M2/GDP ratio which was 27.4 per cent, 20.5 per cent, 13.8 per cent, 13.3 per cent, 18.1 per cent, and 20.3 per cent in 1991, 1992, 1993, 1994, 1995, and 1996 respectively.
17. Considering the leu/$US parity in terms of the PPP, the very low averages in Romania (even when compared with other European post-communist countries), and assuming both a shift of and a speedy movement along the learning curve of Romanian companies (exporters), trade performance can improve even when real wages increase significantly.
18. The state budget deficit was higher in 1994 (–4.2 per cent) than in 1993 (–1.7 per cent), but the 1994 result arose after the exclusion of many implicit and explicit subsidies.
19. The Treasury went increasingly into overdraft in the second half of the year, which was another way for resorting to the NBR’s financing of the budget deficit – apart from the refinancing of the commercial banks’ acquisition of T-bills.

20. That injection was motivated by the non-existence of an insurance scheme for small depositors which would have forestalled a run on the banks.

21. For instance, base money was 7 105 billion lei in December 1996; in April 1997 it was 6 438 billion lei, which in real terms (taking into account inflation of 89 per cent over this period) meant a formidable cut.

22. In mid-October, 1997, RASDAQ quoted around 3 700 companies and the BSE listed 71 firms. According to the VAB (Vanguard) Index, the volume of capitalisation of RASDAQ was over US$2.5 billion, and of the BSE over US$700 million in August 1997. The same index, from a base of 1 000 points at the start of the BSE in November 1995, had reached a level of 2 073 for the whole capital market (both RASDAQ and the BSE) on 21 August, 1997. But these figures are misleading unless the bottom and the peak are noted: the minimum, 273.7 was in November, 1996, and the peak was 2 225, on 16 July, 1997. On the RASDAQ market, the number of actively traded stocks is smaller than the total number of companies listed. Nonetheless, the introduction of appropriate legislation, the increased pace of privatisation, and other policy developments in 1997 have stimulated interest in investing in both markets. Starting in October 1997, a new official index of the BSE (The Bucharest Exchange Trading Index, BET) was put in place.

23. This calculation can be questioned for two reasons: *i)* it does not take into account the lag between the increase of base money and that of the money supply, which is particularly significant taking into account the acceleration of the growth of high powered money in the last quarter; *ii)* it leaves out the excess liquidity in the system existing before the start of the last quarter.

24. Clearly, under this approach one assumes no major shocks to the economy and no dramatic changes in the money multiplier.

25. Data for the last two years show that private companies were major borrowers, which would suggest that their access to credit was not greatly restricted. In fact, the share of these companies in total non-governmental lending increased from 34.2 per cent at the end of 1995 to 46.6 per cent at end-1996. One can certainly elaborate on the restrictiveness of access to credit by looking at the interest rates paid by private companies but, clearly, the crowding-out effect is not as intense as one would have expected – at least for the major private companies (small private companies have a much harder time in meeting the collateral requirements for obtaining credits).

26. In Spring 1995, there were no organised capital markets. The Funds, which operated as quasi-banks, had bad portfolio investments and were basically illiquid. Regulations introduced by the National Securities Commission, required mutual funds to announce net asset values rather than unrealistically elevated ''*expected*'' returns (as they had been doing until then). Mutual fund values collapsed as a result.

27. In December 1996 this ratio was: 4.8 per cent in France, 7.5 per cent in Holland, 5.9 per cent in Slovenia, 10.2 per cent in Bulgaria, and, surprisingly, 17.5 per cent in Hungary.

28. A major implication is that the portion of base money which is actually multiplied is much smaller. This means that, should payments take place through bank intermediation and following a conversion of currently cash balances into bank deposits, the potential for a dramatic change in money supply increases more than significantly.

29. Including nine subsidiaries of foreign banks.

30. The share of bad loans rose from 3.6 per cent in 1995 to 7.9 per cent in 1996; Bancorex Annual Report, 1996.

31. National Bank statistics. It should be noted, however, that around one third of overdue credits is due to the two failed banks (Dacia Felix and Credit Bank). If the element of fraudulent behaviour is taken into account, and a correction coefficient is applied, one can be less harsh in judging the dynamic of the creditworthiness of private companies during recent years.

32. Some banks may indulge in this situation to the extent they expect an easy bailout from the central bank should they need it – *i.e.* the moral hazard problem.

33. The Free Entrepreneurship Decree 54/1990 and the Law 15/1990 on state owned enterprise restructuring were enacted in 1990.

34. The Company Law 31/1990.

35. POFs were set up as follows: POF-I, located in Arad, for wood and furniture industry; POF-II, located in Bacau, for textile, garments industry; POF-III, in Brasov, for trade and tourism; POF-IV, in Bucharest, for chemistry, medicine, construction materials, pottery industries, and POF-V, in Craiova, in charge of electronic electro-technical industries.

36. This programme was initially designed for 30 companies, of which 21 were privatised from July 1992 to July 1993 (the proceeds from the sales amounted to US$2.5 million). Most of the companies belonged to construction, food processing industry, light industry and furniture branches. Employment (some 20 000 jobs) was essentially unaffected by privatisation, as in 19 out of the 21 companies the employees' association was a shareholder and in 14 cases the majority shareholder.

37. The bankruptcy Law was only enacted in 1995. Prior to this law, the sole legislation dealing with bankruptcy was in the Commercial Code and voluntary liquidations were covered by the Company Act (Law 31/1990). These provisions were obsolete and rarely applied, thus there are no significant cases of bankruptcy before 1995. After 1995, the implementation of the bankruptcy procedures was hindered by the lack of institutional framework, notably specialised courts and judges.

38. It was agreed that the first 30 per cent of shares per enterprise would come from POFs' holdings and the next, up to 30 per cent, of shares would come from the SOF's holdings. However, in order for the SOF to maintain its ownership of 70 per cent of overall non-privatised enterprise shares – as has been agreed – it was determined that the POF would have to compensate the SOF for the up to 30 per cent of shares that the latter provided.

39. This estimate of the equity sold by the SOF should be viewed with caution. This estimate does not take into account the adjusted book value of the equity of companies sold prior to mid-1994, when the last re-evaluation was carried out. Taking into account this valuation effects, the number cited slightly understates the actual share of equity privatised.

40. After the adoption in 1996 of a Competition Law, all ''economic concentrations'' above a specified threshold must be notified to the Competition Council (Article 16(1), and the law bans mergers or transfers of control over a company if the transaction, by setting up or consolidating a dominant position, causes or may cause a significant restriction of competition on the Romanian market or any part thereof (Article 13). Under Article 10 of the law, central

and local public administration bodies and other bodies entitled to restructure companies are required to request a recommendation from the Competition Council on how to improve competition.

41. A well-known joke depicted RENEL as the best ‘‘Bank’’ in Romania. The penalties for non-payment of the power bills were typically below the interest rate for short-term bank deposits.

42. Three legislative acts were related to this change: the Ordinance 9/97 regarding labour protection measures for collective dismissals, the Ordinance 10/97 on financial blockage and losses in the economy and the Ordinance 15/97 regarding the completion of the privatisation Law 58/91.

43. National companies are joint-stock companies that will privatised by the line Ministries rather than by the SOF. The authorities argue that this approach is necessary because privatisation of these companies may take one to one-and-a-half years which is beyond the time horizon of the SOF (the latter is supposed to cease its activities by the end of 1998).

44. See Bilsen and Konings, 1996 and Konings, Lehman, and Schaffer, 1996

45. This presentation of the Romanian trade structure follows OECD (1996, 1997) where the reader can find comparable data for other countries. The revealed comparative advantage (RCA) indicator is computed as follows:

$$RCA_i = \left(\frac{X_i}{\sum X_k} - \frac{M_i}{\sum M_k} \right) \cdot 100$$

where X_i and M_i are, respectively, the exports and imports of product i (Neven, 1995). This indicator is bounded between 100 (for exports) and (–100) (for imports). The lower and upper limit of the index can be attained only in the (theoretical) case when there is a complete trade specialisation and there are only two goods. Under real world circumstances, the value of the index rarely exceed 10 (in modules). The higher the value of the index, the stronger trade specialisation. The RCA index can be interpreted as a ‘‘normalised’’ trade balance (*i.e.* given that the sum of the RCA indicator across sectors is equal to zero, the comparative advantages are in this way measured under the theoretical condition of a balanced trade). The value of this indicator is also related to the intensity of intra-industry trade. The stronger two-way trade, the lower specialisation, the closer to zero the index.

46. A surprising fact is that this intense sub-contracting activity did not seem to suffer from a somewhat inefficient customs’ administration. For example, all re-exports had to be processed in the same custom post as they were imported; this requirement is no longer in force, following the introduction of new regulations.

47. In 1995, around 26 per cent of the overall trade of Romania with the four major European countries (Germany, France, Italy and UK) is ‘‘outward processing trade’’ (OPT). This is approximately twice as intensive as in other countries in central and eastern Europe. For the bilateral relations with Germany, the share of OPT is even higher (35 per cent). A typical example is the ‘exports‘ of textile yarn and fabrics from Germany to Romania, which, after processing, are re-exported to Germany as articles of apparel and clothing accessories.

48. See Annex IV for a measure of required structural change as a indication of the level of ‘‘strain’’ in the economy. The latter concept was introduced by Daianu (1997).

49. It is noteworthy that the displacement of workers to the agricultural sectors is not reflected in the table, which does not cover self-employed or family workers.

50. For a detailed analysis of the price and non-price competitiveness in Romania and six other transition countries, see Wolfmayr-Schnitzer *et al*. (1997).

51. Calculations based on data from the Family Budget Survey (FBS), which are not representative of the entire Romanian population. The FBS was replaced in 1994 by the Integrated Household Survey (IHS), which does provide a nationally representative data set.

52. Calculation based on IHS data.

53. Mean household consumption expenditure was used to maintain comparability among existing poverty estimates, although it is generally agreed that a measure relative to the median is preferable.

54. Female-headed households were less frequently poor than male-headed households when the new Romanian equivalence scale was applied, however. In this scale, the weights are based on observed differences in food consumption by age and sex, and therefore do not provide an unbiased measure of nutritional requirements, nor of the economies of scale usually deemed to accompany a larger family size. First, observed consumption may itself be affected by income constraints; secondly, the lower weights apply to females even when they are household heads. For both these reasons, female-headed households are probably under-represented in the poverty count by this equivalence scale, while male-headed households are probably over-represented – Cf. the World Bank (1997), which found that poor one-person households frequently consisted of female pensioners.

55. The sole exception was based on the OECD equivalence scale, which weights additional family members less heavily than the alternative scales employed. By this measure, the poverty rate was lowest in four-person households, while it was equally high in one-person households and those with six or more members.

56. Note that estimates using different equivalence scales were not consistent with respect to which of the two groups – individuals in employee or pensioner-headed households – were more numerous in poverty.

57. This table draws on a data base called the ''labour force balance'', which the National Commission for Statistics compiled from enterprise surveys (employees), land registers (farmers) and fiscal registers (non-farm self-employment). See *Romanian statistical yearbook 1996,* Table 3.1.1.

58. In farming, Romania's labour force surveys count as employed only those who say they work 15 hours per week or more, although the ILO recommends putting the limit at one hour per week. Romania follows this recommendation with respect to other economic sectors. By implication, Romania's LFS probably underestimates the share of agricultural employment compared with other countries.

59. Data about involuntary part-time work and discouraged workers in OECD countries in 1991 were analysed in OECD (1993*a*), Chapter 1. The ''discouraged workers'' are inactive and do not seek jobs, but are immediately available in case a suitable job would appear.

60. The 1996 labour force surveys classified about 88 per cent of those employed in farming as self-employed including unpaid family workers. The Ministry of Agriculture and Food

et al. (1997) reported that 56 per cent of employment in private farming in 1994 was full-time, while 20 per cent was part-time work as a second job and 24 per cent part-time work as the only job. Excluding persons aged 65 or more, the corresponding proportions were 54, 29 and 17 per cent, respectively. See also Gavrilescu and Florian (1996).

61. The average real wage *before tax* in September 1997 was 62 per cent of the level in October 1990, while the tax deducted from an average wage had increased from 16 to 23 per cent.

62. Wage data from the Integrated Household Survey must be used with caution, especially for small occupational groups. But they also suggest that top managers in manufacturing firms receive substantially higher pay under private than public ownership.

63. A new employer-funded insurance covers work-related injuries and diseases. It is compulsory but does not belong to the public social insurance.

64. A per capita equivalence scale (*i.e.* equal weightings for adults and children) was used to determine household consumption expenditure deciles in Figure 25. The tendency of this scale is to underestimate household well-being as household size increases, and the redistributive effect of child allowances in 1996 may be overstated. For the same reason, the redistributive effects of other benefits which are received by households with relatively fewer members – for example, unemployment benefits and pensions – may be understated in Figure 25.

65. The 1996 collective agreement at national level obliges employers to notify redundant workers one month before their dismissal. Trade unions must be notified two months in advance if the dismissal is justified by reductions in the employer's business.

66. The minimum benefit is 20 to 24 per cent of the average wage, depending on the length of service. Between this floor and the ceiling, at 55 per cent of the average wage, benefits depend on the individual's average *after-tax* wage in the last three months, of which it normally replaces 50 per cent after up to five years of work, 55 per cent after five to 15 years of work and thereafter 60 per cent (Article 4 of the 1991 Law on Social Protection of the Unemployed and their Professional Reintegration, as changed by the Emergency Ordinance No. 47, October 1997).

67. MLSP, 1997.

68. The Emergency Ordinance applies when state-owned companies or *Régies Autonomes* dismiss at least 10 persons out of a workforce of 11 to 100, 10 per cent of a workforce of 101 to 300, or 30 persons of a workforce of 300 or more. The basic duration of severance pay is 6 months after 6 months to 5 years of service, 9 months after 5 to 15 years and 12 months after more than 15 years. The three additional months of benefit apply in regions with over 12 per cent unemployment, and, elsewhere, if the local labour market is little diversified or if the recipient has a very specialised occupation.

69. It has recently been decided to set up a voluntary insurance for temporary lay-offs in the construction sector, to be financed by employer and employee contributions.

70. To the extent that severance benefits are paid in other OECD and transition countries, they are usually financed by employers. Varying practices exist with respect to the possibility to combine them with unemployment benefits. In countries where severance benefits are compulsory by law, they typically cover a few months' wages, but longer compensation periods – more similar to those in Romania – are found in Italy, Spain and Turkey.

71. Decision making in enterprises may also be delayed if the benefit payments are subject to budgetary constraints and if there is reason to expect that more funds will be available in the following fiscal year. However, for the first round of application of the Emergency Ordinance, the State Ownership Fund has produced a list of 222 eligible companies. To prevent undesirable delays in other enterprises, it appears important to clarify that all enterprises that fulfil the general conditions in the Ordinance will be declared eligible and given equal treatment.

72. Article 10 of the Emergency Ordinance defines the following as the main active measures: vocational guidance, training in job-seeking methods, entrepreneurial and vocational training, creating consultancy and business development centres, financial support of job creation including works of public interest.

73. During the period 1993-97, PHARE projects involving ALMPs were conducted in 63 Romanian localities. Available (unofficial) documentation suggests that they may have provided job-search assistance for some 30 000 persons and paid subsidies for placement of about 5 000 clients in market-sector jobs.

74. Evaluation research concerning the effects of ALMPs was reviewed in OECD (1993*a*, Chapter 2, and 1996*a*). Specific results of relevance here are discussed by Puhani and Steiner (1996), concerning Poland, and by OECD (1996*b*), concerning Eastern Germany and Sweden.

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Annex I

The package of ‘‘100 laws’’

An important programme of the government elected end-1996 was a package of, so-called, ‘‘100 laws’’ covering the main areas of structural reforms to be adopted in the course of 1997. These legislative reforms are listed below. The numbers correspond to the ranking of the Laws as they appear in the government’s programme. To some extent, this ranking reflects the level of priority. Status of the laws is as of end-October, 1997.

Product markets and foreign trade

1.	Amendment of the Competition Law	passed
2.	Law on tariffs	approved by Gov. Dec.
3.	Price liberalisation of agricultural products	passed
11.	Elimination of non-tariff barriers	approved by Gov. Dec.
12.	Abrogation of the Law 83/93 on direct subsidies to farmers	approved by Gov. Dec.
19.	Abrogation of the Law 20/96 on agricultural support	passed
20.	De-blocking part of state reserves of wheat	approved by Gov. Dec.
28.	Law on the mining sector	approved by Emerg. Ord.
29.	Modification of the Law 75/95 on the production, quality control and use of farm seeds	passed
70.	Law on preferential credits (farmers) for technology and equipment	in drafting
87.	Law on the tourism sector	in drafting
++	Export liberalisation of agricultural products	approved by Gov. Dec.

Tax reform

46.	Modification of the ordinance on VAT	approved by Gov. Dec.
48.	Modification of the Law 118/91 on tax for road maintenance	approved by Emerg. Ord.
53.	Modification of the Law 57/94 on local taxes	approved by Gov. Dec.
60.	Modification of the Accountancy Law No. 82/91	in drafting
67.	Modification of the Law 34/94 on farmer income tax	approved by Emerg. Ord.

76.	Modification of the Law 87/94 on fiscal evasion	approved by Gov. Dec.
82.	Modification of the Law 42/93 on excise taxes	in drafting
61.	Modification of the Ordinance 70/94 on the profit tax	in drafting
71.	Modification of the Law 32/91 on wage taxes	approved by Gov. Dec.

Social policy

4.	Creation of Pension Fund for peasants and a risk fund	approved by Gov. Dec.
5.	Indexation of wages and revenues	approved by Gov. Dec.
6.	Indexation of the minimum wage	approved by Gov. Dec.
7.	Indexation of child allowances	approved by Gov. Dec.
8.	Indexation of state pensions, farmers and unemployment benefits	approved by Gov. Dec.
10.	Indexation of food allowances	approved by Gov. Dec.
24.	Increase of child allowances	approved by Gov. Dec.
25.	Creation of additional child allowances	approved by Gov. Dec.
27.	Indexation of student allowances	approved by Gov. Dec.
56.	Law on Pensions	in drafting
57.	Modification of the legislation concerning child protection and orphan's houses	approved by Gov. Dec.
74.	Law on social housing	...
91.	Framework Law on Social Assistance	passed

Labour markets

9.	Law on collective labour contracts	passed
31.	Legal framework for massive layoffs and severance payments	approved by Emerg. Ord.
59.	Law establishing the National Agency for Employment and Training	in the Parliament
64.	Law on individual labour contracts	...
49.	Creation of a (tripartite) Economic and Social Council	passed

Financial discipline

15.	Obligatory payment of tax arrears and penalties to the state budget	passed
34.	Settlement of the state obligations *vis-à-vis* the banking system	...
43.	Abrogation of the ordinance 13/95 on restructuring and financial discipline	approved by Emerg. Ord.

44.	Establishing wage ceilings for the loss-making RAs and SOEs	in the Parliament
75.	Modification of the Ordinance 13/96 on special conditions for payment arrears	...
89.	Law against money laundering through the financial sector	in the Parliament

Financial markets

33.	Law on bankruptcy of Banks	in the Parliament
35.	Modification of the Banking law 33/91	in the Parliament
36.	Modification of the Law 66/96 transforming the Savings Bank (CEC) into a joint-stock Co.	passed
++	Law on State overdue liabilities towards banks (Banca Agricola)	approved by Emerg. Ord.
37.	Modification of the Law 52/94 on securities and stock exchange	in drafting
39.	Modification of the Law 35/91 on Foreign Investment	passed
40.	Modification of the Law 34/91 on the status of the National Bank of Romania	passed
++	Law on employees associations in companies to be privatised	approved by Emerg. Ord.
77.	Law of the supervision of insurance companies	approved by Gov. Dec.
78.	Law on foreign exchange	in drafting
92.	Law on Private Pension Funds	in drafting

Privatisation and ownership

16.	Modification of the Land Restitution Law No. 18/91	in the Parliament
17.	Allowing legal transfer of Land	in the Parliament
18.	Modification of the Law on Land leasing	in the Parliament
22.	Modification of the Law 58/91 on privatisation	approved by Emerg. Ord.
23.	Modification of the Law 55/95 on mass privatisation programme	approved by Emerg. Ord.
26.	Modification of government ordinance 39/95 on the sale of assets of state-owned firms	approved by Emerg. Ord.
30.	Law on the privatisation of state-owned banks	passed
45.	Law on the general regime of concessions	in drafting

Enterprise restructuring

32.	Completion of the Law 64/95 on bankruptcy	in drafting
38.	Modification of the Commercial Company Law 31/90 and trade register Law 26/90	approved by Emerg. Ord.

41.	Modification of the Law 15/90 on the *Régies autonomes* and state-owned enterprises	approved by Emerg. Ord.
42.	Law on the restructuring of the *Régies autonomes*	approved by Emerg.Ord.
47.	Law on domestic investment	in the Parliament
65.	Law on management contracts	approved by Emerg. Ord.
72.	Law on the legal status of commercial holding companies	in drafting
73.	Law on financial and commercial leasing	approved by Gov. Dec.
93.	Modification of the Law 35/93 on sponsoring	in drafting

Public administration and finance

13.	Law on the state budget 1997	passed
14.	Law on the social security budget 1997	passed
21.	Modification of the Law 91/93 on Public Debt	passed
50.	Modification of the Law on Public Education	approved by Emerg. Ord.
51.	Modification of the Law 69/91 on local administrations	approved by Emerg. Ord.
52.	Modification of the Law on local budgets	passed
54.	Law on public property	in discussion
62.	Law on the Public Budget 1998	...
63.	Law on Social Security Budget 1998	...
66.	Law on automatic wage increases in the public administration	in drafting
68.	Law against corruption	...
79.	Modification of the Law 72/96 on Public Finance	...
85.	Modification of the Law 37/90 on the organisation and functioning of the government	in drafting
86.	Law on organisation and functioning of Ministries and other central govt. institutions	passed for almost all Ministries
++	Law on Ministerial responsibility	in drafting
94.	Law on public servants	in drafting

Energy and environment

58.	Law establishing penalties concerning abuse on the use of forests	...
83.	Law on civil responsibility in case of nuclear accidents	in the Parliament
84.	Law on the fund for the management of radioactive wastes	...
97.	Law on environmentally protected regions	approved by Gov. Dec.
98.	Law on responsibility for pollution	...
99.	Law on air protection	...

100.	Law on protected regions in the national plan for land management	...

Other

55.	Law against drug traffic	...
69.	Law on farm insurance in case of natural disasters	...
80.	Law on private graduate universities	approved by Gov. Dec.
81.	Law on gambling houses	approved by Gov. Dec.
88.	Law on the national heritage	...
90.	Law on foundations and associations	in drafting
95.	Law on product standards	approved by Gov. Dec.
96.	Law on weights and measures	...

Notes:

Emerg. Ord.:	Law passed by an Emergency Ordinance of the Government. Subsequently, these acts will be discussed in the Parliament.
Gov. Dec:	Law passed by a governmental Decree.
++	Law subsequently added to the government programme.

Annex II

The agricultural sector[1]

Understanding the role of the agricultural sector is critical for an understanding of economic adjustment in Romania as a whole, both the difficulties that occurred in the first seven years of the transition process and – looking ahead – the potential for growth in the economy's output and exports. For example:

- in the economic transition at least until 1996, inefficiency and lack of restructuring in large state-owned agricultural operations led to persistent losses and pressures for fiscal and quasi-fiscal subsidies for this sector (see Chapter II); government acquiescence in the face of these pressures repeatedly undermined progress with overall macroeconomic stabilisation;
- the privately-owned farming sector has nevertheless played an important buffer role with respect to overall economic restructuring, providing a source of basic sustenance for many, and of employment – albeit with low productivity and low earnings – for those losing jobs in the industrial sector;
- with rich natural endowments, and large scope for increases in productivity, output and earnings, the agricultural sector could contribute significantly to sustained growth in the economy.

This annex elaborates on these points, reviewing the range of problems that have restrained development of the agriculture sector, and describing the wide-ranging reforms that are currently underway (some basic indicators of recent developments in the sector are shown in Table A1).

The agricultural sector until end-1996

Following the 1989 revolution, agricultural land was rapidly restored to private ownership: the 1991 land reform legislation led to 72 per cent of total agricultural land, and 84 per cent of arable land being held by private farms (mainly individual households – see below). However, this progress was not accompanied by the introduction of complementary institutional reforms needed to develop a competitive, efficient farming sector; moreover, policies that were pursued tended to be ad hoc and at times conflicting. For example, the problems identified in the previous Economic Assessment (OECD,

Table A1. **Basic indicators of Romanian agriculture**

	(units)	1993	1994	1995	1996
Gross output (year on year change)	%	10.2	0.0	4.5	1.3
of which:					
crops	%	14.6	0.0	5.4	1.8
livestock	%	4.2	0.0	3.0	0.6
Real gross value added (year on year change)	%	14.2	2.8	5.2	–3.8
Cereals for grains: area	000 hectares	6 395.0	6 557.6	6 444.8	5 842.8
production	000 tonnes	15 493.0	18 183.0	19 882.8	14 199.7
of which:					
wheat and rye: area	000 hectares	2 307.4	2 440.9	2 501.4	1 797.7
production	000 tonnes	5 354.5	6 186.5	7 709.3	3 164.1
Agricultural and food exports	US$ million	328.7	397.8	531.9	676.7
of which:					
exports to EU	US$ million	110.6	127.3	161.3	145.3
grain exports (volume)	000 tonnes	4.3	7.5	881.1	1 630.4
meat exports (volume)	000 tonnes	76.0	97.2	42.0	37.0
Agricultural and food imports	US$ million	966.6	663.8	895.7	757.9
of which:					
imports from EU	US$ million	455.6	240.6	338.6	300.2
grain imports (volume)	000 tonnes	2 584.9	457.7	62.8	102.2
meat imports (volume)	000 tonnes	42.4	55.0	51.2	. .

Source: National Commission for Statistics.

1993) were still largely unresolved at the end of 1996. In particular, failures were evident on the following fronts.

Land ownership

While the 1991 land reform succeeded in placing most land in the hands of private farmers, deficiencies in the market framework for buying, selling and leasing land left cultivation highly fragmented. Land redistribution was subject to a limit of 10 hectares per household. Although around 20 per cent of agricultural land is farmed by private commercial companies and family associations, as of early-1997 around 4 million small landholders farmed 60 per cent of the land, with an average farm size of only two hectares (Table A2). Land sales were de facto illegal until 1997 reforms: under the 1991 Land Law, land transactions would be legal only if the National Agency for Rural Development and Planning were notified of land offered for sale and given pre-emptive purchase rights, but this Agency was never established. Hence, transactions tended to occur on an informal or disguised basis. Leasing provisions were restrictive regarding contract durations and payment methods, and sub-leases were not allowed. Court block-

Table A2. **Ownership structure of Romanian agriculture, 1997**

	Total number	Total area 000 hectares	Average area hectare
Private sector		11 510	
Per cent of total area		74	
of which:			
agricultural companies	3 956	1 733	433
family associations	15 031	1 499	100
individual households	3 610 494	8 278	2.3
State sector	627	1 338	2 134
Per cent of total area		9	
Public sector		2 616	
Per cent of total area		17	

Source: Ministry of Agriculture and Food.

ages and the lack of an up-to-date cadastral survey has meant that around 40 per cent of farmers do not have title deed, preventing them from using land as collateral for credit. There are also around one million court cases pending on land title disputes and restitution claims (mainly individual claims on land held by state farms, from which the claimants have been receiving dividends rather than title to the land itself). These problems of small farm sizes, fragmented holdings and unclear property rights have impeded growth in agricultural productivity, especially in cases such as grain production where large-scale cultivation and increased mechanisation are needed to improve efficiency.

State-owned farms

State farms produced only 13 per cent of agricultural output in 1996, but play a relatively important role in pig and poultry production – producing around 40 per cent of output in these areas and supplying 74 per cent of the pork market and 82 per cent of that of poultry. These operations tend to have an integrated structure, often covering production of fodder, breeding, raising, and slaughtering their products, and distribution through specialised retail outlets. These farms have persistently been heavy loss-makers, pursuing operations on an excessively large scale and technically inefficient manner (*e.g.* mortality rates and feed conversion rates are respectively 75 and 80 per cent above international benchmarks). As a result, they have accumulated large debts to suppliers and banks (especially Banca Agricola). The state farms have been amongst the largest beneficiaries of directed credits, price subsidies, interest subsidies and other forms of financial support from government (described in more detail below). In 1996, the farms were required to increase animal stocks in order to secure food delivery at low prices – this requirement (pursued for electoral reasons) taking precedence over restructuring measures. Although output price controls have also distorted and probably aggravated their financial position, the farms have been heavily protected by high border tariffs on their products (see below), and domestic prices were above those on the world market. Only two of over 100 farms had been sold as of end-1996. There were also 477 state-owned farms in 1996 producing cereals and other crops, occupying around 16 per cent of total agricultural land (an average size of over 8 000 hectares) but producing only 5 per cent of value added in crop production.

Purchasing, storage and distribution

While production and retailing of agricultural products are mainly in private hands, the intermediate operations have been dominated by state-owned entities. Privatisation of these entities either was not attempted or, when tried, met with only partial success. Three areas are of particular importance – grain purchasing, agriculture service providers, and seed companies. The state-owned grain purchaser Romcereal, responsible for storing grain and supplying funds and inputs to producers, was broken up in early 1996 into a National Agency for Agricultural Products (NAAP), and 41 county-level grain trading companies (Comcereals). Little of substance changed as a result of this break-up, however: NAAP and the Comcereals still owned the entire national storage capacity, the latter now becoming local monopsonies; NAAP was still responsible for contracting with and buying from farmers; and – although offered for sale in the 1996 mass privatisation programme – only nine of the Comcereals moved into majority private ownership. The service providers supply much of the hired machinery, inputs, and transport and distribution services to private farmers. Over 80 per cent of these were still in state ownership as of end-1996. Finally, the seed supply business is largely controlled by two state-owned enterprises (Semrom and Unisem).

Price controls

Various forms of direct price controls and administered prices existed until end-1996. Retail prices of over one-half the average household's food consumption, including dairy products, pork, poultry and bread, were subject to formal price ceilings or price ''negotiations'' (for sugar and edible oils) between producers, processors and the government. A system of administered prices applied to wheat, milk, pork and poultry: farmers selling these products to state-owned processors and distributors faced fixed farmgate prices, but were entitled to receive additional premium payments; margin controls were then applied along the marketing chain of storage, processing, wholesaling and retailing. While sales at market prices were possible outside this system, state control of key parts of the marketing network (see previous point) meant that the bulk of these products was sold at the administered prices.

External trade

Despite a number of measures adopted since 1989 to improve the overall openness and market-orientation of Romanian trade (such as greater emphasis on tariffs rather than quantitative import restraints, elimination of forced exports, and participation in multilateral and bilateral trade agreements), trade in agricultural goods tended to remain protectionist and subject to various direct and indirect controls. Under the framework of the Uruguay Round Agreement, Romania negotiated a high level of protection:[2] when the Agreement came into effect on 1 July, 1995, average tariffs on agricultural products rose from 25 per cent to 80 per cent (although subject to many exemptions and waivers), including tariffs of 236 and 135 per cent respectively on pork and poultry. Quotas and bans were applied to a variety of exportable products, and the overvalued official exchange rate provided further disincentives for exports.

Financial support for agriculture

Given the complex and interacting structural problems described above, sustaining the agricultural sector has required the repeated injection of huge amounts of public funds. It is this problem that came to a head in 1996 and contributed largely to the destabilisation of the macroeconomic situation in the second half of the year. Financial support for agriculture has occurred both on- and off-budget, totalling nearly 6 per cent of GDP in 1996. As noted above, the bulk of this support has gone to state-owned enterprises (especially the pig and poultry farms), with little assistance provided to private farmers or to consumers. The 1996 budget contained 2.2 trillion lei (2 per cent of GDP) of direct state expenditure for agriculture, mainly for price premia and interest subsidies. As discussed in Chapter II, spending of 0.6 trillion from the agricultural pension fund was almost entirely funded by transfers from the state budget (totalling 0.5 per cent of GDP). In addition, the State Ownership Fund (SOF) provided some 75 billion in credit subsidies at zero interest to state-owned agricultural enterprises. It is also noteworthy that agricultural enterprises benefit from a lower corporate tax rate of 25 per cent, rather than the standard rate of 38 per cent.

The main off-budget source of support comprised directed credits, largely channelled via Banca Agricola and refinanced by the National Bank. Together with the implicit interest subsidy in the NBR refinancing, this quasi-fiscal support totalled around 2.5 per cent of GDP in 1996. Estimates of net arrears of state-owned agricultural enterprises – debts mainly to banks – are included in total quasi-fiscal support on the basis that most will not be repaid and will eventually become a charge on the budget.

The buffer role of agriculture

Notwithstanding the difficulties described above, the agricultural sector has played a significant buffer role with respect to overall economic restructuring, providing a source of employment, income and basic sustenance for many affected by the transition process. The land reforms in 1990-91 created 6 million land owners, of whom 40 per cent are in urban areas. Many of those moving back to farms are elderly and lacking in experience in the sector. Farming is of largely a subsistence form: money earnings from wages and sales of agricultural products provide only around one-quarter of total incomes of peasant farmers, and measured poverty rates are significantly higher than in urban areas (see Chapter IV). Nevertheless, the option of returning to family farms has been (and apparently still is) an important safety net for urban employees and others facing job loss or earnings' reductions[3] – taking pressure off the unemployment rolls and social security system.

Employment in agriculture (including self-employed) increased by 0.5 million, from 28 to 36 per cent of total employment, between 1990 and 1994, before falling back somewhat to 34 per cent of employment in 1995. This employment growth occurred almost entirely on the small private farms that arose through the land reforms. The close links of many households with farms are also important with respect to food supply. Significant quantities of agricultural products flow directly from rural to urban households, both as in-kind rent payments and within family groups. Reflecting these flows, self-consumption – which accounts for 55 per cent of the total consumption of peasant households – also provides 20 per cent of consumption of employee households and 35 per cent for unemployed households.

Current reform programme

Since taking office at the end of 1996, the new government has begun to implement an ambitious and wide-reaching reform programme for the agricultural sector. This programme, the key condition for a US$350 million Agricultural Sector Adjustment Loan from the World Bank, addresses the full range of problems noted above. If implemented successfully, these reforms should play a key role in supporting fiscal and monetary stability – sadly lacking in the first seven years of transition – and in helping Romania to recapture some if its underlying comparative advantages in agriculture that were clearly evident earlier this century.

The main elements of the reform programme are as follows:

– an end to directed credits and other forms of off-budget financing of agriculture, with all support now shown transparently in the consolidated budget (see Chapter II). There are to be no further rounds of debt cancellation or rescheduling for state enterprises. Projected state spending on agriculture (also including forestry) in 1997 equals 1.4 per cent of GDP (compared with 2.4 per cent in 1996);
– targeting of agricultural support on private producers rather than state-owned operations: for example, the 1997 budget includes limited funds to support small landholders through crop purchases, seed subsidies, and fertiliser supply (the latter two items made available through a voucher scheme);

– increased contributions from beneficiaries to the agricultural pension fund: state budget transfers to this fund are projected to account for 58 per cent of 1997 expenditures, compared with 95 per cent in 1996 (although they remain at around 0.5 per cent of GDP, as overall revenue and expenditure have increased);
– an end to all price and margin controls along the agricultural production chain: these prices have been fully liberalised as of 1 February, 1997. As a result, prices of bread, meat and dairy products increased by around 50 per cent and contributed one half of the overall CPI increase in the first quarter;
– large reductions in tariffs, combined with elimination of quotas, import licences, export bans and other quantitative restrictions (except for some products coming within the scope of WTO, EU and other international agreements). Tariffs have been lowered from an average of 75 per cent at end-1996 to 27 per cent in 1997. This includes reductions in tariffs on pork and poultry to no more than 60 per cent. In both cases, the new maximum tariff level still appears to exceed the margins needed to protect domestic producers: the difference between domestic producer prices and import prices is estimated at 48 per cent for pork and 32 per cent for poultry. Agricultural trade will also be helped by Romania's membership of the CEFTA (since 1 July 1997), and by adjustments in the EU-Romania Association Agreement in 1997;
– rapid privatisation or liquidation of all the state-owned agricultural enterprises, including the animal and vegetal farms; suppliers of machinery services, seeds and other inputs; and the Comcereals and NAAP. The goal is to have privatisation largely completed by mid-1998. Assessments of the viability and market value of these enterprises are complicated by the large debt burden which some of them face (*e.g.* the pig and poultry processors). These debts stem in part from the price controls imposed on this sector in the past. In a *flow* sense, the current financial condition of at least some producers may have improved markedly (especially as a result of price liberalisation), but enterprises are still liable for their *stock* of past losses;
– liberalisation of the land market: new land reform legislation *inter alia* frees up land transactions between individuals (including removing the state's pre-emptive purchase rights); raises the amount of land that can be purchased by an individual family (from 100 to 200 hectares); allows Romanians resident abroad (but not foreigners) to buy land; allows subleasing arrangements (in which foreigners are allowed to participate); and accelerates the restitution or sale of land held by state farms and the provision of titles to landholders;
– restructuring and eventual privatisation of Banca Agricola (see Chapter II). The budget also provides limited funds for a loan subsidy and bonus scheme, designed to encourage a wider set of financial institutions to enter the rural finance market.

Annex III

The ''energy problem'' in Romania

Despite a large endowment of domestic hydrocarbon resources, energy shortages have always been a major concern in Romania (see IEA, 1993 and OECD, 1993). There are big production capacities – as installed capacity in the electricity sector is more than triple the peak demand –, but there are difficulties to obtain the primary energy inputs. After the exchange rate crisis of end-1995, the energy import restrictions induced short-term shutdowns of many companies and created problems with home heating. The particularly low energy efficiency in heavy industries explains the relatively high energy dependence (even by Eastern European standards, with the exception of Bulgaria).[4] Imports of fuels and other mineral products account for roughly 26 per cent of total imports.[5]

Monetary policy was also conditioned by an artificially overvalued exchange rate as a mean of providing an implicit subsidy for imports of energy by the heavy industries. Low energy prices have also provided a quasi-fiscal subsidy to energy consumers and have contributed to the deterioration of the financial position of energy producers (*e.g.* RENEL, ROMGAZ; see Chapter III).

Previously, prices played no role in resource allocation, thus there was little incentive to improve energy efficiency. However, evidence on the particularly low energy efficiency in Romania is not totally straightforward to obtain. Indeed, according to the usual indicators of aggregate energy efficiency, Romania has significantly lower levels than the OECD area, but ranks among other Eastern European countries. For example, at 1995 exchange rates, the energy intensity of GDP in Romania is lower than in the Czech Republic, Poland, Bulgaria or the Slovak Republic. At PPP exchange rates, energy efficiency still appears comparable with the Slovak Republic and Bulgaria and less intensive than Russia and Estonia (Table A3). All these aggregate indicators are somewhat flawed by the problem of comparing like with like; *i.e.* dollars of GDP in Romania and in other countries. A more detailed analysis is needed here.

Along these lines, a more meaningful comparison can be made using levels of energy inputs per unit of physical output of a homogeneous (or relatively highly substitutable) good. For this purpose crude steel can be a good candidate. According to this indicator, among a set of both transition and OECD countries, Romania appears as

Table A3. **Aggregate indicators of energy intensity**

	TPES/GDP (toe per thousand 90 US$) [1]		TPES/GDP (toe per thousand 90 US$ PPP) [1]	
	1990	1995	1990	1995
Czech Republic	1.74	1.70	0.50	0.49
France	0.19	0.19	0.22	0.23
Hungary	0.86	0.82	0.43	0.41
Japan	0.15	0.16	0.19	0.20
Poland	1.66	1.45	0.50	0.44
Portugal	0.24	0.27	0.16	0.17
Spain	0.18	0.20	0.19	0.20
United Kingdom	0.22	0.21	0.23	0.22
United States	0.35	0.34	0.35	0.34
Bulgaria	1.32	1.40	0.71	0.76
Romania	**1.58**	**1.26**	**0.76**	**0.60**
Slovak Republic	1.61	1.55	0.61	0.59
Slovenia	0.30	0.33	0.26	0.29
Estonia	1.35	1.17	0.76	0.66
Russia	1.46	1.68	0.76	0.88
EU15	0.20	0.19	0.23	0.22
OECD total	0.25	0.24	0.26	0.26
Non-OECD total	0.78	0.73	0.34	0.29
World total	0.36	0.35	0.30	0.28

1. TPES : Total primary energy supply.
Source: IEA.

having the highest energy input per ton of crude steel produced (Table A4, panel A). Another indicator is the efficiency of electricity generation (panel B). Romania exhibits a low performance in terms of electricity produced by unit of primary energy consumed. Finally, the losses in the distribution of gas and electricity are also compared (panel C). In this respect Romania is in the range of other Eastern European countries (Bulgaria, Poland) with approximately double the losses in some OECD countries.

A large adjustment of energy prices took place in early 1997. Prices were basically doubled and will henceforth be adjusted automatically on a monthly basis according to changes in the exchange rate and world energy prices (notably oil). The government also decided to restructure the *Régies autonomes* involved in the energy sector. More competition will be introduced in the production of electricity, for instance. The restructuring of the economy will also help because the share of light industries (less energy-intensive) is also increasing. Still, given the level of the ‘‘energy problem’’ in Romania, a solution may require a significant investment effort directed towards increasing energy efficiency.

Concerning energy-related pollution, emissions of greenhouse gases (CO_2, NO_x and SO_x) decreased substantially since 1990 (Figure A1). This is the direct consequence of

Table A4. **Cross-country comparisons of energy intensity**

A. Comparisons of physical output indicators

	TFC iron and steel, thousands TOE (1)		Production crude steel, thousands tonnes (2)		Energy consumption in % of output (1)/(2)	
	1995	1994	1995	1994	1995	1994
Romania	**3 724**	**3 150**	**6 555**	**5 793**	**56.8**	**54.4**
Bulgaria	1 341	1 192	2 725	2 491	49.2	47.9
Czech Republic	3 213	2 881	7 188	7 068	44.7	40.8
Hungary	902	823	1 860	1 932	48.5	42.6
Poland	5 803	5 468	11 856	10 980	48.9	49.8
Slovakia	1 967	. .	3 960	. .	49.7	. .
France	7 720	7 290	18 108	18 036	42.6	40.4
Germany	14 560	14 330	42 048	40 836	34.6	35.1
Sweden	1 710	1 720	4 932	4 956	34.7	34.7
UK	7 660	7 370	17 676	17 376	43.3	42.4
USA	19 350	20 080	93 600	88 860	20.7	22.6
Spain	3 680	3 780	13 440	13 932	27.4	27.1

B. Comparisons of electricity generation

	Production electricity, thousands TOE (1)		Consumption of electricity plants, thousands tonnes (2)		Electricity generation in % (1)/(1) + (2)	
	1995	1994	1995	1994	1995	1994
Romania	**2 360**	**2 151**	**6 679**	**6 895**	**26.1**	**23.8**
Bulgaria	2 780	2 474	5 856	5 224	32.2	32.1
Czech Republic	4 103	4 024	8 940	8 823	31.5	31.3
Hungary	2 736	2 689	5 422	5 344	33.5	33.5
Poland[1]	. .	. .	. .	. .	. .	. .
Slovakia	1 905	1 835	3 342	3 275	36.3	35.9
France	41 950	40 570	70 620	66 790	37.3	37.8
Germany	45 800	45 120	81 080	81 080	36.1	35.8
Sweden	11 810	11 410	12 250	12 810	49.1	47.1
UK	27 100	26 810	45 310	43 980	37.4	37.9
USA	269 950	265 630	448 510	447 680	37.6	37.2
Spain	13 480	13 190	20 770	19 910	39.4	39.8

1. Only CHP plants.

Table A4. **Cross-country comparisons of energy intensity** *(cont.)*

C. Comparisons of distribution losses

	Distribution losses electricity, thousands TOE		TFC electricity, thousands TOE		Distribution losses gas, thousands TOE		TFC gas, thousands TOE		losses/TFC in %, electricity		losses/TFC in %, gas	
	1995	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995	1994
Romania	**–579**	**–436**	**3 126**	**2 941**	**–534**	**–938**	**10 128**	**9 250**	**–18.5**	**–14.8**	**–5.3**	**–10.1**
Bulgaria	–467	–408	2 467	2 279	–83	–96	2 096	1 789	–18.9	–17.9	–4.0	–5.4
Czech Republic	–410	–401	4 135	3 867	–284	–290	5 455	4 895	–9.9	–10.4	–5.2	–5.9
Hungary	–408	–366	2 360	2 363	–353	–242	5 893	5 444	–17.3	–15.5	–6.0	–4.4
Poland	–1 554	–1 488	7 713	7 338	–261	–468	7 781	7 274	–20.1	–20.3	–3.4	–6.4
Slovakia	–182	–170	1 869	1 778	–139	–100	4 071	3 212	–9.7	–9.6	–3.4	–3.1
France	–2 580	–2 200	29 460	29 000	–50	–50	28 000	27 480	–8.8	–7.6	–0.2	–0.2
Germany	–2 150	–1 920	38 800	38 150	–470	–430	51 280	47 320	–5.5	–5.0	–0.9	–0.9
Sweden	–770	–780	10 710	10 530	0	0	370	380	–7.2	–7.4	0.0	0.0
UK	–2 140	–2 660	25 610	24 450	. .	. .	. .	. .	–8.4	–10.9	. .	. .
USA	–21 740	–20 710	261 590	254 240	. .	. .	. .	. .	–8.3	–8.1	. .	. .
Spain	–1 370	–1 300	12 120	11 780	110	70	6 350	5 610	–11.3	–11.0	1.7	1.2

TFC: Total final consumption.
TOE: Tons of oil equivalent.
Source: IEA.

Table A5. **Cross-country comparison of greenhouse-gas emissions**

Per capita

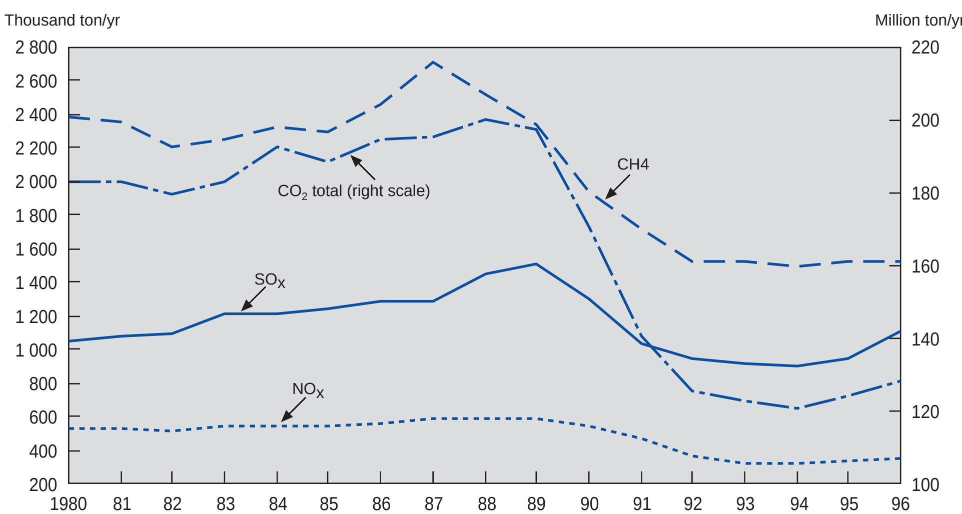
	SO_x		NO_x		CO_2	
	1980	1993	1980	1993	1980	1993
Romania	**4.75**	**4.08**	**2.36**	**1.40**	**782.9**	**552.2**
USA	10.44	7.56	9.43	8.23	2 094.6	1973.9
France	6.21	2.13[1]	3.05	2.65[1]	903.9	638.3
Netherlands	3.46	1.07	4.13	3.56	1 123.7	1 118.4
Spain	5.70[2]	5.68[3]	2.21[2]	3.21[3]	525.2	570.5
Hungary	15.25	8.01[1]	2.55	1.77[1]	812.6	610.3[1]
Poland	11.47	7.06	4.02[2]	2.90	1 256.5	912.4

1. 1992.
2. 1985.
3. 1990.

Source: OECD, National Commission for Statistics.

the dramatic output fall which occurred in the early years of transition. Associated with the low living standards, emissions per capita in Romania rank well below some OECD countries (Table A5). In sum, Romania combines a large scope for technological catch-up in terms of energy efficiency with a still low level of emissions per capita.

Figure A1. **ENERGY RELATED EMISSIONS**



Source: National Commission for Statistics.

Annex IV

Strain and structural change

As opposed to a command system, market economies are assumed to possess a high capacity for absorbing shocks due to their intrinsic flexibility and ongoing micro-adjustments. When faced with a dramatic and sudden change in relative prices, as happened in the post-communist countries after 1989, an economy can adapt more or less easily. While the dynamics of such an adjustment process depend on many interactions (including non-economic factors) and therefore are difficult to measure, it is possible to provide a measure of the *distance* between two states of an economy at two points in time. This distance conveys some information about the degree of the required adjustment.

Daianu (1997)[6] proposed an indicator of the required aggregate adjustment of the economy to reach the set of new relative prices. In a way, this indicator can be viewed as the intensity of required adjustment following the shock represented by the relative price change. Depending on the magnitude of this required structural change, an economy can be more or less under *strain* (according to the term coined by Daianu, 1997). Depending on its level, strain may produce unacceptable social costs, but it can also act as a catalyst to concentrate resources, raise flexibility and thereby speed-up the transition; in other words, it can enhance adjustment.

In a more formal way, the *required structural change* (J) can be defined as the distance between two vectors of prices and quantities, as follows:

$$J = \frac{\sum_i q_i \,.\, | p_i - p_i^* |}{\sum_i p_i^* \,.\, q_i^*}$$

where p_i and q_i refer to current prices and quantities (at the start of transition) for the sector (i) and the (*) denotes their level after the full adjustment takes place. The latter could be associated, for instance, with a shift towards international prices and an economic structure closer to a western country[7] (*e.g.* lower share of employment in agriculture and in industry, and expansion of the service sector). A higher J means a larger required change in relative prices. Another way of portraying this structural change is to focus on quantity rather than on price adjustment:

$$J' = \frac{\sum_i p_i \,.\, | q_i - q_i^* |}{\sum_i p_i^* \,.\, q_i^*}$$

These two indicators are dual measures. Ideally, the economy would adjust both on prices and quantities at the same time. In practical terms, the price adjustment tends to proceed more rapidly. In order to take into account both dimensions, the aggregate distance of both price and quantity adjustments can be computed as follows:

$$\overline{J} = \sqrt{J^2 + J'^2}$$

Figure A2 provides the basic intuition underlying this indicator.

The distance between the price and quantity structures in the labour market in Romania and a reference point is compared with other countries in Table A6. This reference point was defined, in a somewhat arbitrary way, as the structure of relative wages (on the price side) and employment (on the quantity side) in the UK for the year 1994 (latest data available). Another benchmark country could be used; the key results do not change dramatically if, for example, France was chosen instead of the UK.

Figure A2. **ILLUSTRATION OF ONE STRAIN INDICATOR**

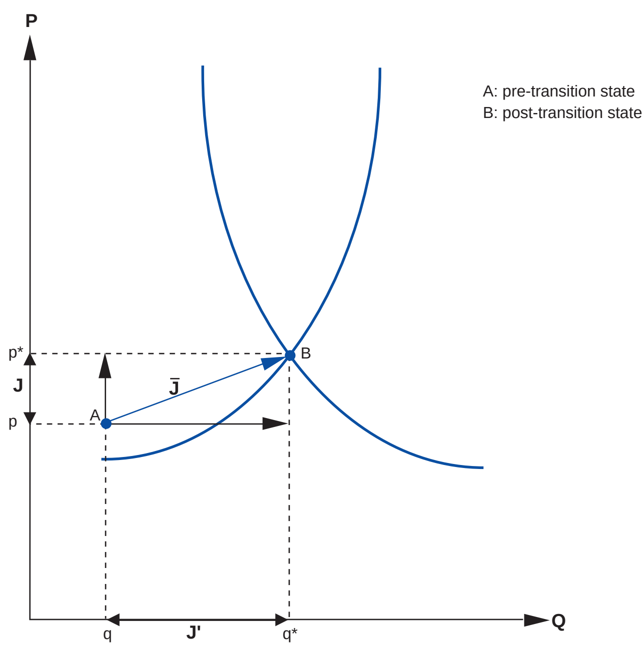


Table A6. **Structural adjustment in the labour market: a cross-country comparison**

	Romania		Hungary		Poland		Czech Republic		Slovakia		Slovenia		*Memo-randum item:* France	*Reference Point:* UK
	1990	1995	1992	1995	1992	1995	1991	1995	1991	1995	1993	1995	1992	1994
Relative wages (average monthly earnings = 100)[1]														
Agriculture and forestry	**104.2**	**81.6**	68.9	76.8	82.3	90.6	97.2	84.2	99.7	81.7	105.3	95.5	*72.5*	*77.9*
Industry	**98.6**	**107.6**	99.0	104.0	98.7	108.9	104.5	99.2	101.4	104.3	84.9	85.0	*111.1*	*116.5*
Constructions	**110.9**	**106.4**	90.2	84.4	106.1	92.5	106.2	108.0	102.4	104.8	83.0	82.5	*98.6*	*109.2*
Trade, hotel and restaurant	**86.1**	**78.2**	97.0	90.0	90.3	88.9	85.8	88.2	89.3	94.0	102.2	99.8	*90.9*	*69.9*
Transport, communications	**108.5**	**121.0**	105.8	106.5	102.1	101.2	102.1	100.7	102.1	108.4	115.0	110.9	*105.4*	*144.6*
Financial banking and insurance, real estate and other services	**109.3**	**126.8**	144.7	137.4	147.7	137.3	99.9	130.7	103.9	131.4	143.8	124.6	*128.0*	*136.8*
Education, health and social assistance	**96.5**	**85.3**	93.5	86.5	86.9	81.7	93.2	91.2	97.6	87.2	111.8	109.6	*75.8*	*53.0*
Public administration and defence, other branches	**88.9**	**88.6**	118.0	111.3	115.7	108.9	88.5	103.8	103.4	102.5	127.8	132.7	*91.0*	*93.6*
Index of ''strain''[2] on prices	**23.0**	**9.8**	24.1	19.7	18.3	17.0	21.1	19.1	23.8	17.2	33.9	33.1	*11.7*	
(excluding agriculture)	**21.2**	**12.9**	26.0	21.3	22.9	18.1	21.2	20.0	24.0	18.6	34.5	34.8	*12.0*	
Employment shares (%)														
Agriculture and forestry	**29.0**	**34.4**	11.4	8.1	25.5	22.6	12.1	6.6	15.8	9.2	10.7	10.4	*5.2*	*2.0*
Industry	**36.9**	**28.6**	30.2	27.1	25.2	25.9	41.0	33.2	35.9	30.3	38.7	38.0	*20.6*	*20.2*
Constructions	**6.5**	**5.0**	5.4	6.0	6.6	6.1	5.7	9.2	8.2	8.6	5.4	5.1	*7.2*	*6.4*
Trade, hotel and restaurant	**6.7**	**10.4**	14.8	15.9	10.7	13.6	7.8	15.7	8.1	13.1	14.6	15.4	*17.4*	*20.8*
Transport, communications	**7.0**	**5.9**	8.6	8.8	5.5	5.8	9.0	7.7	5.5	7.8	6.5	5.9	*5.8*	*5.8*
Financial banking and insurance, real estate and other services	**3.9**	**4.2**	5.2	5.9	1.3	2.0	5.4	6.7	5.4	5.8	4.6	6.1	*10.8*	*12.5*
Education, health and social assistance	**6.7**	**8.1**	13.6	15.6	13.1	13.3	13.8	12.1	16.5	14.5	10.2	11.4	*6.9*	*14.5*
Public administration and defence, other branches	**3.1**	**3.4**	10.6	12.5	12.1	10.7	5.1	8.8	4.6	10.7	9.2	7.6	*26.2*	*17.9*
Index of ''strain''[2] on quantities	**91.4**	**76.6**	47.6	37.2	60.4	56.7	68.1	47.1	68.7	45.9	62.2	56.7	*13.8*	
(excluding agriculture)	**76.4**	**57.5**	41.5	33.7	46.0	42.4	63.1	44.4	63.4	43.2	52.9	48.3	*21.8*	
Indicator of total ''strain''[2]	**94.2**	**77.2**	53.3	42.1	63.1	59.2	71.3	50.8	72.6	49.0	70.9	65.6	18.1	
(excluding agriculture)	**79.3**	**59.0**	49.0	39.9	51.4	46.1	66.6	48.7	67.8	47.0	63.2	59.5	24.9	

1. Gross monthly earnings, except for Romania was net.
2. The ''strain'' indicator is computed as a distance between the structure of relative wages and employment *vis-à-vis* the UK in 1994. (see text).

Source: National Commission for Statistics, OECD and Secretariat's calculations.

The results suggest four main points:

i) As expected, the distance between the UK and the transition countries, in particular Romania, is much higher than the distance between the UK and a country like France. It is important to confirm this basic and intuitive result before pursuing further the interpretation of the indicator.

ii) The distance for the case of Romania is much higher for the employment structure than for relative wages. Somewhat surprisingly, Romania had even by 1995 a much closer relative wage structure to the UK than other countries in transition. This suggests that prices have adjusted much faster than quantities.

iii) However, the overall required adjustment (combining the price and quantity sides) is the highest in Romania.

iv) Finally, without the agricultural sector, the structure of the Romanian economy would appear much closer to the other countries in transition.

This indicator confirms some of the features of the Romanian economy that are discussed throughout the present Survey. Notably, the legacy of the previous economic structure appears to be particularly heavy in Romania, at least when compared with other transition countries in Central and Eastern Europe. This may explain why there was so much resistance to structural change and to the level of adjustment that is implied in the current reform programme.

Annex V

Features of social protection

Table A7. **Institutional description of main social protection programmes in Romania 1997**

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Pensions			
Old-age pension	– Standard retirement age is 62 years for men and 57 for women. Upon request: 60 years for men and 55 for women. Required years of service is 30 years for men and 25 for women; – hazardous work (group 1): retirement age is 50 years for both men and women, if 20 years of service; – hazardous work (group 2): *a)* women who have brought up at least 3 children can retire at the age of 50 if 20 years of service; *b)* long term unemployed with less than 5 years up to retirement age can retire at 55 if 25 years of service.	54% – 84% of reference wage depending on work categories and years of service.[1]	1. Pensions are financed from the following sources: – Old-age pensions: social insurance state budget, agricultural pension fund and state budget; – Supplementary pensions: supplementary pension fund; – Disability pensions: social insurance state budget and agricultural pension fund; – Survivors pensions: social insurance state budget and agricultural pension fund. 2. Contribution rates: – social insurance state budget: employer contribution is 23-28% of payroll; – agricultural pension fund: agricultural companies pay mandatory 2-4% of revenues; – supplementary pension fund: mandatory contribution for employees is 3% of gross salary.
Supplementary pension	Contribution length. Minimum required contribution time is 5 years.	8% – 15% of reference wage, depending on length of contribution (minimum if 5 years of contribution; maximum if more than 25 years of contribution).[1]	

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Disability pension	Employee who lost their work capacity as a consequence of work accident, disease; – 1st degree: total loss of work capacity, need of care; – 2nd degree: total loss of work capacity, no need of assistance from another person; – 3rd degree: partial loss of work capacity	1st degree: 100% of old-age pension; 2nd degree: 85% of old-age pension; 3rd degree: 60% of old-age pension. Commences after 180 days of receiving sick pay.	
Survivor pensions	Widow (aged 55 or more) and children under 16 (25 if in full time education) if the husband/father was pensioner or fulfilled retirement conditions.	Benefits are related to pensions paid or payable to insured pensioners: – one survivor: 50%; – two survivors: 75%; – three or more survivors: 100%.	
Social pensions	Retirement age and at least 10 years of work.	Benefits are paid proportionally to old-age pension, depending on number of years in work.	
Sickness benefit	Employment.	85% of previous earnings if work-related illness/injury. If not work-related: 50% if less than 2 years of work, 65% if 2-5 years of work, 75% if 5-8 years of work and 85% if more than 8 years of work. Duration: up to 180 days. People injured during 1989 revolution are entitled to sickness benefit at 100% of their previous wage with no duration limit.	1. Sickness benefits are paid from social insurance state budget. 2. Contribution rate: see pension contribution above. 3. Employer pays first 10 working days of sick leave, thereafter the benefits are paid by social insurance state budget.

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Family allowances			
Child allowance	All resident children.	50 000 lei per child and month (Apr. 97). Duration: up to 16 years (up to 18 years if in full time education).	1. Family allowances are financed from the following sources: – child allowances: state budget; – supplementary child allowances: state budget and risk and accident fund; – maternity benefit and maternity leave: social insurance state budget, agricultural pension fund and state budget; – birth grant: local budgets; – family placement allowance: local budgets; – allowance for military service wives: state budget. 2. Contribution rates: for social insurance state budget and agricultural pension fund, see pension contribution above. Employers pay 1% of payroll to the risk and accident fund.
Supplementary child allowance[2]	Families with more than 2 children.	– Families with 2 children: 40 000 lei per month (July 97); – families with 3 children: 80 000 lei per month; – families with more than 4 children: 100 000 lei per month. Duration: up to 16 years (up to 18 years if in full time education).	
Maternity benefit and maternity leave for taking care of children up to two years[3]	Insured mothers who are covered by state social insurance (SSI), agricultural pension fund or are in military service.	Mothers covered by SSI and mothers in military service receive 85% of salary. Mothers covered by agricultural pension fund receive 80% of the average monthly insured income in the last 6 months of contribution. Duration: 112 days (maternity benefit) + 2 years (maternity leave).	
Birth grant	Provided for each born child, starting with the second child.	253 000 lei per month and child (Oct. 97).	

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Family placement allowance	Families which take care of abandoned/orphan children.	150 000 lei per month and child (Oct. 97).	
Allowance for military service: wives	Wives that meet one of the following requirements: – earn less than minimum wage; – pregnant more than 4 months; – have children younger than 7 years.	30 100 lei per month (Oct. 97).	
Unemployment			
Unemployment benefit	Unemployed and 6 month of employment in the last 12 months.	– 50% of the average earnings in the last 3 months if 1-5 years of employment; – 55% if 5-15 years of employment; – 60% if more than 15 years of employment; Maximum benefit is 2 minimum wages. Duration: 9 months.	All unemployment programmes are financed from the unemployment fund.
Support allowance	Unemployed and newly graduated with entitlement to unemployment benefit or graduates allowance. Support allowance is income-tested. It is not possible to receive the allowance if: – the family own land (20 000 sq.m. in plain area or 40 000 in mountain area); – average income per person in the family exceeds 60% of minimum wage.	60% of minimum wage. Duration: 18 months.	
Technical unemployment subsidy	Employees of companies whose activities are temporary ceased.	Same as unemployment benefit.	

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Graduates allowance	Newly graduated from school and universities who cannot find suitable employment within 60 days after graduating; newly discharged from the military. Entitlement is not allowed when: – the family own land (20 000 sq.m. in plain area or 40 000 in mountain area); – other income sources amounts to at least 50% of minimum wage; – the graduated refuses to take a suitable job situated less than 50 km of residence; – the graduated refuses training; – the graduated is entitled to retirement.	60% of minimum wage for undergraduates and 70% of minimum wage for graduates. Duration: 9 months.	
Severance payment	Persons without labour contract due to mass lay-offs, with at least 6 months of employment.	– 6 average monthly salaries if 6 months – 5 years of employment; – 9 average monthly salaries if 5-15 years of employment; – 12 average monthly salaries if more than 15 years of employment; The benefits can be supplemented with maximum 3 average salaries if: – unemployment rate in the region is higher than 12%; – few different occupations exist in the residence area; – the profession is very specialised.	Severance payment can be paid as a lump-sum if the beneficiary start an enterprise.
Active Labour Market Programmes			
Subsidised loans to SMEs hiring unemployed	Small and medium sized enterprises (SMEs) with less than 200 employees. At least 50% of the hired persons must be unemployed.	Credits with subsidised interest (50% of National Bank discount rate).	All active labour market programmes are financed from unemployment fund.

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Graduates wage subsidy	Newly graduated with employment.	Wage subsidy: 60% of minimum wage for undergraduates, 70% of minimum wage for graduates. Duration: 9 months.	
Qualification/ requalification	Recipients of unemployment benefit or support allowance.		
Support for low income families			
Social aid	Income-tested, based on following family net income ceilings (Oct. 97): – one person family: 114 700 lei per month; – two person family: 206 600 lei per month; – three person family: 288 400 lei per month; – four person family: 361 800 lei per month; – five person family: 430 800 lei per month; – more than five person family: 63 900 lei per person.	The benefit equals the difference between the ceiling and family income.	1. Support for low income families is mainly financed from local budgets. Emergency help is financed both from local budgets and the state budget. 2. Bread subsidy was in force between March and September 1997.
Allowance for thermal energy	Provided for family whose each member net income is: below 275 000 lei or between 275 000 lei – 550 000 lei	110 000 lei 40 000 lei	
Social canteens	– Children under 18 years, from families with monthly income per person less than 30% of minimum wage; – disabled and chronically ill elderly with no income; – any person with insufficient income and need to cover minimum daily intake of calories.	Equivalent of 4 800 lei per day.	

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Bread subsidy (since March 1997)	Income-tested.	*a)* 13 500 lei per month per person for: – employees with salary less than 600 000 lei per month; – pensioners (except farmers pensioners) with pension less than 300 000 lei per month; – unemployed; – social aid beneficiaries. *b)* Pensioners with farmers pensions receive 9 500 lei per month. *c)* Persons in care institutions receive 450 lei per person per day.	
Emergency help	Calamities and emergencies.	Varies.	
Disability benefits			
Social pension	Blind people: 1st degree: total loss of work capacity, need of care; 2nd degree: total loss of work capacity no need of assistance.	–1st degree: 100% of minimum gross wage; – 2nd degree: 50% of minimum wage. Duration: As long as the handicap lasts.	1. All programmes are financed from the risk and accident fund. 2. Social pensions: – blind persons who cumulate salary with old age pension, IOWW pension or disability pension can choose between one of these pensions and the social pension; – blind persons who don't have salary income cumulate social pension with one of the above mentioned pensions.
Special Aid	– Disabled adults; – income and means-tested, survivor pensions are not included in the income test.	50% of minimum gross wage. Duration: no limit.	
Indemnity for companion	Persons who take care and permanently help disabled child or adult.	Equivalent of minimum salary of a junior social assistant. Duration: care period.	

Table A7. **Institutional description of main social protection programmes in Romania 1997** *(cont.)*

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
Financial facilities and benefits in kind (transport, health, RTV /telephone subscription etc.)	Invalidity.		
Support for war invalids or political persecuted persons			
Pensions for war invalids, orphans and widows	Injured or relative to an injured/ killed person in World War II.	Disability pensions (as of February 97): – 1st degree: 230 000 lei per month; – 2nd degree: 203 000 lei per month. Army degree soldiers can receive higher pension benefits. 1st degree pensioners are also entitled to indemnity for companion, which amounts to 26 000 lei per month.	All programmes are financed from the state budget.
Pension for injured during the 1989 ''revolution'' and pensions for their survivors	Injured or relative to injured/ killed person in the 1989 ''revolution''.	Disability pensions (as of July 97): – 1st degree: 915 000 lei per month; – 2nd degree: 767 750 lei per month; – 3rd degree: 549 000 lei per month. 366 000 lei per month (Apr. 97) for mothers of dead heroes.	
Cash benefits for political prisoners	Persons who have been in prison for political reasons, psychiatric sanatoria, deported etc.	– 60 000 lei per month for each year of prison; – 30 000 lei per month for persons who have been admitted to psychiatric hospitals.	

1. Reference wage is average base earnings of best five consecutive years during last ten years of work.
2. Introduced in July 1997: replaces the existing ''pension for several children mothers'' which was a life time pension.
3. Until July 1997, the duration of maternity leave was one year.

Memorandum item: In February 1997, minimum wage was 150 000 lei per month.

Source: Ministery of Labour and Social Affairs and OECD.

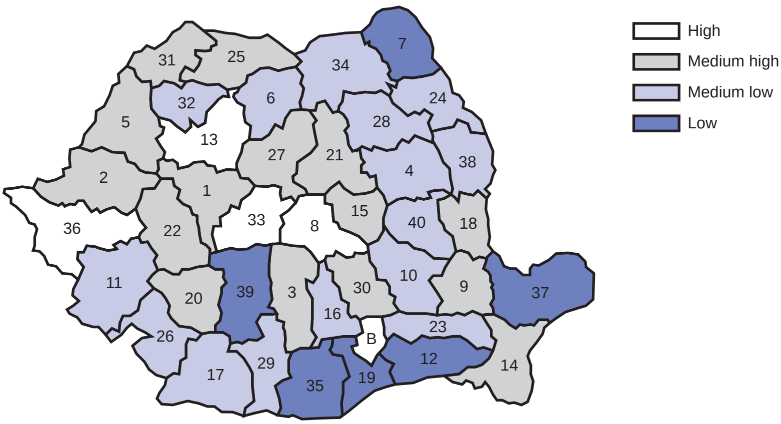
Annex VI

Regional dimensions of economic activity

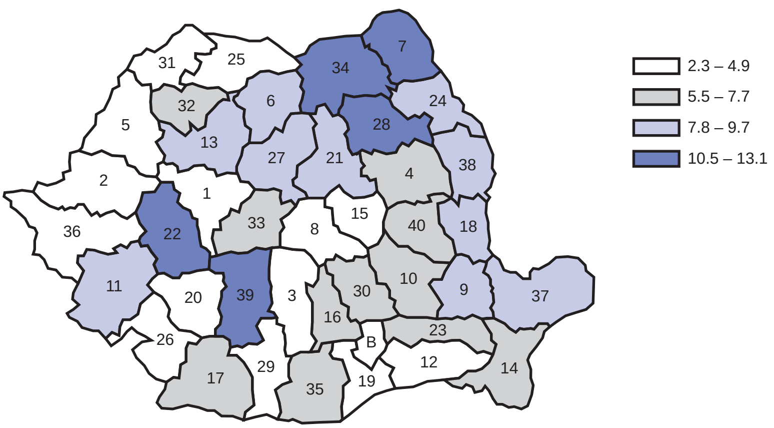
This annex provides two indicators of regional disparities in economic development. The global development indicator (produced under the PHARE programme) is based on 17 indices grouped into four categories: the local economy (GDP per capita and unemployment); infrastructure (*e.g.* density of rail, road and telephone networks); demography (*e.g.* population density and age structure); and family standards of living (*e.g.* cars per 1 000 population, education level, infant mortality). Data are drawn mainly from 1994 (see PHARE, 1996[8]). The second graph displays regional unemployment disparities for the year 1996. The regional differences are rather marked, with the lowest development level and highest unemployment appearing to be mostly concentrated in the Eastern regions.

Figure A3. **THE REGIONAL DISTRIBUTION OF THE GLOBAL DEVELOPMENT INDEX AND UNEMPLOYMENT RATE**

A. Global development index



B. Regional unemployment, 1996



Bucharest	B								
Alba	1	Braila	9	Dolj	17	Maramures	25	Sibiu	33
Arad	2	Buzau	10	Galati	18	Mehedinti	26	Suceava	34
Arges	3	Caras	11	Giurgiu	19	Mures	27	Teleorman	35
Bacau	4	Calarasi	12	Gorj	20	Neamt	28	Timis	36
Bihor	5	Cluj	13	Harghita	21	Olt	29	Tulcea	37
Bistrita	6	Constanta	14	Hunedoara	22	Prahova	30	Valcea	38
Botosani	7	Covasna	15	Ialomita	23	Satu Mare	31	Vaslui	39
Brasov	8	Dambovita	16	Iasi	24	Salaj	32	Vrancea	40

Source: National Commission for Statistics; Phare, 1996.

Annex VII

Competition policy[9]

As enacted in 1996, the Romanian Competition Law is a modern and for the most part workable competition statute.[10] The key articles in the law define and set out mechanisms for dealing with anti-competitive agreements, abuses of a dominant position, and economic concentrations (mergers or other transfers of control of a company) that may create a dominant position. The law declares that the prices of products and services will in general be set freely, through competition, and it gives competition authorities a role in setting the prices of *Régies autonomes,* natural monopolies, and certain other companies.

Romania's competition law is broadly consistent with those of OECD countries. It was drafted to be enforced by an independent governmental entity, the Competition Council, but shortly before the final vote in Parliament, a role was also created for a Competition Office that is responsible to the government. The resulting (somewhat unclear) division of responsibility is the most unusual feature of the law.

The Competition Council is an autonomous body whose 10 members are appointed for five-year terms by the President based on proposals from the Senate and the Chamber of Deputies. The law strictly lays out Council Members' necessary qualifications, forbids them from other work except higher-level teaching, and also forbids them from membership in political parties or other political organisations. The Chairman of the Council has Ministerial status. At present, the Council has a staff of about 65 people, about 30 of whom are professionals, with a total authorised staff of 90 people. Future plans contemplate a total staff of about 190 people.

The Competition Council plays a quasi-judicial role, deciding on the basis of investigations by Council or Competition Office staff whether conduct violates the Competition Law, but it also has a wide range of other powers, including carrying out investigations and providing expert advice to the government and to other public bodies (''competition advocacy''). It is authorised to consult with other ministries, including the SOF, and both central and local public administrations with the power to restructure companies are required to seek the Council's advice. All mergers and other structural changes in the control of companies above a threshold determined by the Council must be notified to the Council.

The Competition Office has fewer powers than the Competition Council, and a larger share of its powers may be more regulatory. The Office's main responsibilities include conducting investigations of alleged violations of the Competition Law or of the Council's decisions and approving prices to be charged by *Régies autonomes,* natural monopolies, and certain other companies. The Head of the Office is just below the Ministerial level. The Office currently has a total staff of about 450 people, and future plans contemplate a total staff of about 900 people.

The existence of two competition agencies raises a number of issues that must be addressed to ensure coherent, effective, and consistent competition law enforcement. From a policy and a legal perspective, the Competition Council is clearly the pre-eminent agency, but with its much smaller staff the Council must in general be able to rely upon the Office to conduct the investigations it considers necessary. Moreover, the Council must in general be able to rely on the Office to refrain from conducting investigations (or taking other actions) that the Council considers inconsistent with effective competition law enforcement. Finally, the Council and the Office must devise co-ordinated procedures for opening investigations in order to avoid duplication and to ensure that in general investigations of particular matters are conducted only once and by the most qualified agency (in terms of sectoral expertise, resources, etc.). Currently, there is uncertainty when the Office is legally required to comply with Council decisions, but the legal issue might not need to be resolved if the two agencies can agree that they will consult on these matters and that after consultation the Office will accept the Council's decision except in extraordinary circumstances. Such an agreement would preserve some separate authority for the Office, and that separate authority might not undermine coherent, effective, and consistent enforcement if it was used only in truly extraordinary circumstances.

Other institutional issues are also important. To assure the Romanian public and foreign investors in the integrity of the competition law enforcement system, it is important that competition law enforcement officials not have relationships with enterprises that give rise to real or apparent conflicts of interest. At present, for example, the Competition Council is opposing the formation – by a former high level official in the Competition Office and the current heads of various Competition Office territorial administrations – of a ''foundation'' that would apparently offer competition law advice to specific firms. Even though the foundation would be a non-profit entity, such an arrangement clearly could create real or apparent conflicts of interest. Both the Council and the Office should adopt rules for their staffs that deal explicitly with such issues and prevent real or apparent conflicts from tainting the competition law enforcement process.

In addition, if Romania intends to give competition policy a central role in its regulatory activities, as recommended in the OECD Regulatory Reform report, there is need for clear and consistent support at the higher levels of government for the competition-enhancing mission of the Council and the Office. This support is particularly needed for competition advocacy, because the resolution of competition problems in many areas will require co-ordination between the competition agencies and other state bodies. The Competition Law provides for the necessary consultation, but government support is important to encourage actual co-ordination. Government support for law enforcement is also necessary.

It is particularly important that privatisation officials co-ordinate with competition officials. Under the Competition Law, all ''economic concentrations'' above a threshold must be notified to the Competition Council (Article 16[1]), and the law bans mergers or transfers of control over a company if the transaction, by setting up or consolidating a dominant position, causes or may cause a significant restriction of competition on the Romanian market or any part thereof (Article 13). Under Article 10 of the law, central and local public administration bodies and other bodies entitled to restructure companies are required to request a recommendation from the Competition Council on how to improve competition. The precise interaction between these provisions and the laws governing privatisation is not entirely clear, but in any event privatisation officials should co-ordinate with the Competition Council both to learn about potential competition problems and to eliminate or minimise the possibility that a privatisation could be delayed.

Price regulation

The Competition Law provides that the Competition Council is to make recommendations concerning the prices of products supplied by *Régies autonomes*, provided under natural monopoly conditions, or subject to special regulations. The law also gives the Competition Office authority to approve such prices. Price controls were maintained on 24 groups of products, covering basic food products (including bread, milk, pork and poultry), transport, energy and other public utilities.

As noted earlier, extensive price liberalisation and the adjustment of controlled prices toward international levels were among the earliest moves of the new government that came into office in late-1996. For example, prices of energy, transport, water, and post and telephone services doubled (or more) in the first few months of 1997. Moreover, the government passed an emergency ordinance in February, amending the 1996 Competition Law: this ordinance stipulates exactly which prices are to remain under control and presents a simple, transparent mechanism for adjusting these prices. The most important controlled prices are those of electric and thermal energy; rail, river and city transport; postal and telephone services; water and sewerage; and certain medicines. Following their adjustment to international levels, these prices have now been indexed (100 per cent) to movements either in the CPI or the exchange rate (the latter being used in the case of international postal and telephone charges, and of energy). Adjustments are monthly in most cases.[11]

Additional reforms which could lead to further liberalisation of public service prices are taking place or being considered. Mobile phone services are already open to competition, and these prices are not controlled; the separation of energy production from distribution is being investigated; and the rail network has been opened to private trains (on the Bucharest-Constanza line, albeit with the national rail company SNCFR as a shareholder in the company concerned).

Notes

1. Developments and problems in the Romanian agricultural sector have been extensively documented elsewhere, including OECD, 1997*a* and 1997*b*. The previous Economic Assessment of Romania (OECD, 1993) gives a detailed discussion of the problems at that time, many of which persisted in largely the same form until the comprehensive reform programme that began in 1997. The present review makes extensive use of these sources.
2. The level of protection was set at a higher level than in Poland, Hungary, the Czech Republic and Slovakia – which sits at odds with the widely-held belief that Romania has a comparative advantage in agriculture. It should be noted that Romania has developing country status in the WTO, and as such is not subject to the same strict policies on agriculture under the three pillars (domestic support, export subsidies and market access) as developed countries.
3. An employer in a large manufacturing enterprise noted that his ability to cut wages was effectively constrained by the fact that, at some point, his employees would choose to return to their family farms.
4. See UN Economic Survey of Europe 1995-96, p. 112.
5. See ''The Romanian Foreign Trade after 1989'', Ministry of Trade, 1996.
6. Daniel Daianu: ''Explaining shocks in post-command economies'' (in French), Revue d'Études Comparatives Est-Ouest, 1, 1997 and in J. Backhaus (ed.): Issues in Transformation theory, Marburg, Metropolis, 1997.
7. This may give a justification for computing the strain indicator at a relatively aggregated level. At a detailed sectoral level, it would be much less meaningful to use a western country as a benchmark.
8. ''The regional dimensions of Romania'', Phare report.
9. This annex was prepared in cooperation with OECD/DAFFE.
10. See OECD (1998) Annex VIII for a discussion of the role of competition policy.
11. The price adjustment is made only if the relevant index is at least +/–5 per cent different from its level as of the previous adjustment. Internal phone and postal charges are adjusted quarterly.

Annex VIII

Chronology of economic events

1990

January/April

Decree Law No. 54/90 authorising establishment of small businesses and carrying out economic activities on a free initiative basis.

Decree Law No. 96/90 authorising wholly-owned foreign investments.

Decree Law No. 122/90 permitting establishment of foreign representative offices.

Five day working week in effect.

May

Election of the new government.

July

Law No. 15/90 reorganises state-owned enterprises as commercial companies and *Régies autonomes* (RAs) respectively.

November

Law No. 26/90 on the Trade Register (''Registrul Comertului'').

Law No. 31/90 on commercial companies.

1991

January

Commercial and economic co-operation agreement with the EU signed.

G-24 extends assistance to Romania.

Law No. 31 on preventing ''unfair'' competition.

February/April

New Land Law passed.

Law No. 32/91 on taxes on wages and salaries.

Law No. 33/91 on Banking activities.

Law No. 34/91 on the statute of the National Bank of Romania.

Law No. 35/91 on Foreign Investment.

Inter-bank foreign exchange market created by the National Bank of Romania.

Romania granted assistance by the IMF.

July/August

Law No. 47/91 on insurance companies.

Measures of price liberalisation.

Legislation adopted on the privatisation of commercial companies.

November

Government decision on partial (internal) convertibility of the leu.

Adoption of the New Constitution by the Romanian Parliament.

December

Law No. 82 on the Accounting system.

1992

April

Law No. 40/92 on establishment of the dividends of commercial companies.

May

Government decision on further liberalisation of the foreign trade system (export and import licences).

June/July

New Foreign Exchange regulations allowing full retention of foreign exchange earnings and introduction of the managed floating exchange rate regime.

Law No. 66/92 providing facilities for attracting foreign capital in oil and gas exploration and exploitation.

Law No. 84/92 on the establishment of free economic zones.

August/September

Organisation of the State Ownership Fund (SOF) and five private Ownership Funds (POFs).

1993

February

Signature of the Association Agreement with the EU.

April

Law ratifying the provisional agreement with the European Communities of Coal and Steel.

Law ratifying the agreement with the EFTA.

June/August

Law No. 76/92 on financial discipline.

Introduction of the value-added tax.

Amendment of the Foreign Investment Law.

Government Ordinance to encourage the development of SMEs.

October

Law No. 66/93 on management contracts.

Most Favoured Nation (MFN) status received for trade with the USA.

1994

January/March

Government Ordinance on measures for strengthening financial discipline.

Law No. 15/94 on capital amortisation.

May

Law on taxes and local taxes.

Law ratifying the Marrakech agreement founding the WTO.

July/August

Law No. 52/94 on securities stock exchange.

Law No. 71/94 granting facilities for foreign investment in industry.

Law No. 77/94 on Management-Employee Buy-outs (MEBOs).

Opening of the interbank foreign exchange market.

Establishment of the National Securities Commission.

October

Law No. 87/94 on measures to prevent fiscal evasion.

November

Launching of a public offer for three commercial companies by the SOF.

1995

February

The Association Agreement with the EU entered into force.

Government decision on exemption and temporary reduction in customs duties for some imports.

April

Finalisation of the process initiated by the POFs converting ownership certificates into shares for more than 100 commercial companies.

Law ratifying the framework Convention for the protection of ethnic minorities.

Opening of the Multilateral InterBank Clearing House.

June

Law No. 55/95 on acceleration of the privatisation process (Mass Privatisation Project).

Law No. 64/95 on commercial bankruptcy.

Opening of the Bucharest Stock Exchange.

September

Start of the Mass Privatisation Project (MPP).

December

Law No. 119/95 on measures to accelerate restructuring of RAs and state-owned companies, strengthen financial discipline and improve settlements in the economy.

Law No. 136/95 on insurance and re-insurance.

1996

January

Government Ordinance on the strengthening of financial and foreign exchange discipline.

April/May

Law No. 21/96 on Competition Policy.

Law No. 31/96 on the State Monopolies.

May

Samurai Bonds and EuroBonds worth US$720 million are launched.

June

Local elections announce a shift of popular support from the ruling coalition towards the opposition parties.

July/August

Law No. 66/96 on restructuring of the Romanian Savings Bank (CEC) into a joint-stock company.

Law No. 72 on Public Finance.

Law No. 88/96 amending the Law No. 58/91 on the privatisation of commercial companies.

Government Ordinance on the Guarantee Fund for deposits with the banking system.

September

The RASDAQ – over the counter – market is created.

November

Law on collective labour contracts.

General elections. The coalition of the Democratic Convention of Romania headed by Emil Constantinescu, the Social Democratic Union of Petre Roman and the Hungarian Democratic Federation won the elections.

1997

January

The package of ‘‘100 Laws’’ is announced.

The NBR increases the discount rate from 35 to 50 per cent.

Resumption of negotiations with the IMF and the World Bank.

February

Appointment of new chairman for the SOF and definition of new policy priorities.

Government agrees on budget for 1997 incorporating substantial subsidy cuts.

The new government announces the implementation of a shock therapy programme and price liberalisation was decided.

IMF pledges US$1 billion loan to promote macroeconomic stability in Romania.

South Korean conglomerate Daewoo buys majority stake in Romanian shipyard.

The NBR announces that it will no longer compute the reference rate for the leu as a further measure to liberalise the foreign exchange market.

Large increase in prices of fuel, electricity, public transport and telecommunications.

Agricultural restructuring measures outlined, supported through the World Bank agricultural sector adjustment loan (ASAL).

March

The Chamber of Deputies passes a Law granting foreigners the right to own land.

Standard and Poor’s affirms the ratings of BB – for foreign currency and BBB – for local currency long-term.

April

Romanian government and IMF sign letter of intent on a support package.

Romanian government passes decree on unemployment assistance and mass lay-offs.

NBR withdraws licence from two private banks (Dacia Felix Banka and Creditbank).

Chamber of Deputies approves bank privatisation law.

The IMF grants the first US$60 million tranche of the stand-by loan.

Romania and Turkey sign a free-trade agreement.

June

The EU applies provisional anti-dumping duties on iron and non-alloy steel pipes produced in Russia, the Czech and Slovak Republics and Romania.

The World Bank approves a package of US$550 million structural loans to Romania.

The Romanian government issues Eurobonds worth DM 500 million.

Romania and the European Investment Bank (EIB) sign a financial co-operation framework agreement.

The NBR opens lei deposits with six commercial banks. This instrument is used to replace the auction for refinancing credits.

By a vote of 227 to 158, the Parliament rejects a motion of no-confidence in the government proposed by the opposition parties.

The Chamber of Deputies adopts the modification of the Privatisation Law.

Emergency Ordinance on the new Foreign Investment Law.

The Ministry of Industry starts the restructuring of the mining sector.

July

The Chamber of Deputies passes the Health Insurance Law.

The government modifies the Law on Management Contracts allowing Romanian companies to have either Romanian or foreign managers.

The Chamber of Deputies adopts the Emergency Ordinance on Foreign Investment.

Lay-off of 23 000 employees in the education sector.

August

The IMF rejects the increase in the level of foreign debt that would have been implied by the acquisition of 96 Cobra military helicopters.

Adoption by the government of Ordinance 32 simplifying the procedures to set up commercial companies.

The Government approves the Ordinance on Leasing.

Septembre

Massive lay-offs in the mining sector (around 60 000 workers).

The IMF agrees to release a second US$82 million tranche of the stand-by loan.

October

The government approves the new Customs Regulations.

The new Land Law is promulgated. According to the new law, former land owners who owned more than 10 hectares of arable land have the right to claim the restitution of the whole property, up to 50 hectares.

The Chamber of Deputies passes the draft law on the status of the NBR.

December

The Prime Minister announces a Cabinet reshuffle including the creation of a new Ministry of Privatisation.

Annex IX

Statistical annex

Table A8. **GDP by expenditure**

Billion lei

	1990	1991	1992	1993	1994	1995	1996
Current prices							
Final consumption expenditure	679.5	1 672.5	4 642.5	15 235.8	38 452.4	58 634.4	87 823.4
Private	557.7	1 323.7	3 750.8	12 670.3	31 442.0	49 515.4	75 721.6
Public	121.8	348.8	891.7	2 565.5	7 010.4	9 119.0	12 101.8
Gross capital formation	259.5	618.1	1 893.5	5 795.9	12 348.3	17 684.4	27 765.1
Gross fixed capital formation	169.8	317.0	1 156.8	3 583.7	10 095.7	15 924.9	25 470.3
Change in inventories	89.7	301.1	736.7	2 212.2	2 252.6	1 759.5	2 294.8
Total domestic demand	939.0	2 290.6	6 536.0	21 031.7	50 800.7	76 318.8	115 588.5
Exports	143.5	388.0	1 675.6	4 611.5	12 394.2	20 176.3	30 050.7
Imports	224.6	474.6	2 182.5	5 607.5	13 421.7	23 935.4	36 123.8
Net exports	–81.1	–86.6	–506.9	–996.0	–1 027.5	–3 759.1	–6 073.1
GDP	857.9	2 203.9	6 029.2	20 035.7	49 773.2	72 559.7	109 515.4
At prices of the previous year							
Final consumption expenditure	614.1	599.4	1 579.1	4 700.2	15 813.2	43 948.1	61 094.6
Private	500.7	467.4	1 223.9	3 783.9	13 003.9	37 449.6	52 611.8
Public	113.4	132.0	355.2	916.3	2 809.3	6 498.5	8 482.8
Gross capital formation	211.8	187.9	542.7	1 837.3	5 286.0	12 336.2	18 267.2
Gross fixed capital formation	154.0	116.1	351.8	1 252.9	4 326.1	10 960.6	16 771.7
Change in inventories	57.8	71.8	190.9	584.4	959.9	1 375.6	1 495.5
Total domestic demand	825.9	787.3	2 121.8	6 537.5	21 099.2	56 284.3	79 361.8
Exports	101.2	117.8	399.2	1 862.0	5 489.4	16 438.3	19 682.5
Imports	172.0	158.1	510.3	2 278.2	5 765.1	19 438.4	23 529.8
Net exports	–70.8	–40.3	–111.1	–416.2	–275.7	–3 000.1	–3 847.3
GDP	755.1	747.0	2 010.7	6 121.3	20 823.5	53 284.2	75 514.5
At 1989 prices[1]							
Final consumption expenditure	614.1	542.5	513.1	520.0	542.5	609.0	629.8
Private	500.7	419.6	388.0	391.4	401.7	478.5	508.4
Public	113.4	122.9	125.2	128.6	140.8	130.5	121.4
Gross capital formation	211.8	153.4	134.7	130.7	119.2	119.0	123.0
Gross fixed capital formation	154.0	105.3	116.9	126.6	152.8	165.9	174.7
Change in inventories[2]	57.8	48.1	17.8	4.1	–33.6	–46.8	–51.7
Total domestic demand	825.9	695.9	647.8	650.7	661.7	728.1	752.8
Exports	101.2	83.1	85.5	95.0	113.1	150.0	146.3
Imports	172.0	121.1	130.2	135.9	139.7	202.3	198.9
Net exports	–70.8	–38.0	–44.7	–40.9	–26.6	–52.4	–52.6
Statistical adjustment	0.0	–0.4	–3.2	–0.8	–2.1	1.9	5.0
GDP	755.1	657.5	599.9	609.0	633.0	677.6	705.2

1. Computed by re-basing the prices indices in the year 1989.
2. Stocks = Gross capital formation - Gross fixed capital formation.

Source: National Commission for Statistics.

Table A9. **Industrial production**

	1990 = 100							Growth rate in %			Structure in % of	
	1991	1992	1993	1994	1995	1996	Sept. 97	1996/ 1990	1995/ 1996	Sept. 97/ 1996	1990	1995
Industry	77.2	60.3	61.1	63.1	69.0	75.8	66.6	–24.2	9.9	–12.2	100.0	100.0
Mining and quarrying	81.7	81.0	79.9	81.3	80.8	80.2	56.2	–19.8	–0.7	–30.0	8.9	6.8
Coal mining and preparation	83.4	95.6	96.8	99.5	99.7	102.4	52.0	2.4	2.7	–49.2	1.0	2.2
Petroleum and natural gas extraction	85.4	82.1	82.4	80.8	80.2	78.3	70.2	–21.7	–2.4	–10.3	6.8	3.6
Metalliferrous ore mining and preparation	77.2	72.1	72.7	83.0	80.3	76.0	49.7	–24.0	–5.4	–34.6	0.5	0.5
Other extraction activities	74.5	49.5	44.8	40.9	42.2	41.4	44.2	–58.6	–1.9	6.8	0.6	0.5
Manufacturing	76.2	57.9	58.3	60.5	67.8	76.3	70.3	–23.7	12.5	–7.8	85.8	80.5
Food and beverages	80.9	66.3	57.1	64.6	66.0	64.2	52.6	–35.8	–2.8	–18.0	14.4	16.3
Tobacco	97.0	96.6	84.5	81.0	84.8	92.7	104.7	–7.3	9.3	13.0	0.5	0.5
Textile and textile product	83.3	57.9	56.6	57.1	56.1	46.5	40.8	–53.5	–17.2	–12.2	6.8	3.7
Textile, furs and leather clothing	88.9	61.8	59.0	85.6	105.1	144.8	130.9	44.8	37.8	–9.6	3.6	2.1
Leather and footwear	83.9	59.5	58.5	65.6	70.8	64.4	55.1	–35.6	–9.0	–14.5	1.9	1.5
Wood industry	76.5	62.2	56.5	48.1	47.3	49.1	40.6	–50.9	3.9	–17.4	1.6	1.9
Pulp, paper and cardboard	68.9	51.1	46.6	46.6	61.2	56.5	51.7	–43.5	–7.6	–8.6	1.2	1.2
Publishing houses, polygraphy, recording and copying	. .	100.0	145.1	254.7	314.7	408.5	. .	. .	29.8	. .	0.3	1.1
Petroleum processing, coal coking and treatment of nuclear fuels	64.1	57.0	56.5	66.8	67.3	61.4	48.8	–38.6	–8.7	–20.6	6.9	7.7
Chemical industry and synthetic and artificial fibres	73.5	56.2	58.3	53.6	58.6	55.4	37.5	–44.6	–5.4	–32.4	7.3	8.7
Rubber and plastics processing	72.2	50.6	53.5	43.8	46.0	47.8	36.5	–52.2	4.0	–23.7	2.6	2.1
Other products of non-metallic minerals	77.2	62.6	62.6	57.8	64.2	67.7	66.8	–32.3	5.5	–1.4	3.5	3.8
Metallurgy	71.2	50.1	54.1	56.5	66.4	65.7	68.8	–34.3	–1.0	4.7	8.5	10.4
Metallic constructions and metal products	83.4	58.5	54.0	46.2	55.3	56.4	57.9	–43.6	1.9	2.7	4.1	2.8

Table A9. **Industrial production** *(cont.)*

	1990 = 100							Growth rate in %			Structure in % of	
	1991	1992	1993	1994	1995	1996	Sept. 97	1996/ 1990	1995/ 1996	Sept. 97/ 1996	1990	1995
Machinery and equipments	65.1	50.9	52.4	49.4	60.5	78.8	62.3	–21.2	30.3	–21.0	9.3	5.8
Computers	61.5	44.9	32.6	35.9	38.0	50.4	16.0	–49.7	32.5	–68.2	0.5	0.2
Electric machinery and apparatus	70.9	47.0	50.4	78.1	97.6	124.0	165.5	24.0	27.0	33.5	2.5	2.0
Equipments, radio, TV sets and communications	88.5	57.9	69.1	148.3	185.2	338.0	382.3	238.0	82.5	13.1	0.8	0.9
Medical, precision, optical and watchmaking instruments and apparatus	81.0	59.8	60.1	51.7	69.5	98.1	79.8	–1.9	41.2	–18.7	1.1	0.4
Road transport means	75.3	53.3	67.1	61.0	61.4	76.4	83.8	–23.6	24.5	9.6	3.7	3.0
Other transport means	74.6	63.8	71.7	56.4	66.8	80.1	115.2	–19.9	19.9	43.8	2.3	1.5
Furniture and other non-classified activities	94.3	76.7	99.4	112.3	144.9	218.1	186.0	118.1	50.5	–14.7	2.2	2.6
Waste and material remains recycling	. .	100.0. .	94.2	95.2	97.2	88.6	. .	. .	–8.9	. .	0.2	0.3
Electric and thermal energy gas and water	90.6	84.1	89.9	89.8	92.8	94.4	64.0	–5.6	1.7	–32.2	5.2	12.6
Production and distribution of electric and thermal power, of gas and hot water	83.3	78.0	79.8	79.6	81.6	83.2	54.3	–16.8	2.0	–34.8	5.0	11.6
Water caption, purification and distribution	. .	100.0	158.1	170.4	189.9	189.5	. .	. .	–0.2	. .	0.2	1.0

Source: National Commission for Statistics.

Table A10. **Monetary survey**

End-quarter, billion of lei

	Q1 1994	Q2	Q3	Q4	Q1 95	Q2	Q3	Q4	Q1 96	Q2	Q3	Q4	Q1 97	Q2	Q3
Net foreign assets	1 264.3	1 174.2	1 670.9	1 866.7	1 115.5	1 316.8	859.4	724.3	273.9	–103.1	–549.6	–560.8	–2 980.9	3 843.6	9 088.9
Domestic credit	4 852.1	4 872.6	6 545.6	9 183.4	10 169.9	11 872.5	14 213.2	17 399.0	19 340.2	21 521.6	24 869.5	31 450.1	40 298.4	37 697.2	42 592.0
Credit to government, net	–873.8	–1 742.2	–1 391.7	–301.2	–565.5	–25.1	168.6	963.6	1 264.8	1 639.0	2 709.7	4 608.6	5 216.8	1 501.5	4 375.4
Credit to non-government	5 725.9	6 614.8	7 937.3	9 484.5	10 735.3	11 897.7	14 044.6	16 435.4	18 075.3	19 882.6	22 159.8	26 841.5	35 081.6	36 195.7	38 216.6
In lei	4 447.8	5 114.6	6 121.1	7 434.7	8 196.4	8 832.2	10 300.0	11 575.2	12 323.4	13 361.5	14 570.0	16 943.0	16 582.8	15 590.1	14 898.0
In foreign exchange	1 278.1	1 500.2	1 816.2	2 049.9	2 538.9	3 065.5	3 744.6	4 860.1	5 752.0	6 521.1	7 589.8	9 898.5	18 498.8	20 605.6	23 318.6
Other assets, net	–885.7	243.9	–170.9	–401.4	–94.1	–435.9	–450.2	154.8	–254.4	–13.4	–206.4	–554.8	548.1	2 416.1	–154.2
Broad Money (M2)	5 230.7	6 290.7	8 045.5	10 648.7	11 191.2	12 753.4	14 622.3	18 278.1	19 359.7	21 405.2	24 113.5	30 334.5	37 865.6	43 956.9	51 526.7
M1	2 132.9	2 670.1	3 320.8	4 534.2	4 068.7	4 639.0	5 516.3	7 083.2	6 416.1	7 347.9	8 506.4	11 173.3	8 948.2	11 854.1	14 762.9
Currency outside banks	1 050.2	1 386.2	1 764.0	2 200.6	2 016.4	2 501.8	3 086.9	3 760.5	3 291.3	3 931.6	4 271.0	5 382.7	4 741.1	6 362.8	8 359.1
Demand deposits	1 082.6	1 283.9	1 556.8	2 333.6	2 052.3	2 137.2	2 429.5	3 322.7	3 124.8	3 416.3	4 235.4	5 790.6	4 207.1	5 491.3	6 403.8
Quasi money	3 097.9	3 620.6	4 724.7	6 114.5	7 122.5	8 114.4	9 105.9	11 194.9	12 943.6	14 057.4	15 607.1	19 161.2	28 917.4	32 102.8	36 763.8
Households deposits	742.1	1 196.2	1 774.9	2 727.6	3 278.4	3 738.8	4 230.1	5 136.4	6 042.4	6 921.0	7 431.0	8 808.1	10 981.3	14 565.6	16 286.8
Lei deposits (legal persons)	581.2	657.6	874.2	1 028.7	1 298.2	1 457.2	16 98.8	1 926.5	2 154.1	2 278.1	2 746.7	3 267.5	4 104.4	4 462.5	5 111.3
Forex deposits of residents	1 774.5	1 766.8	2 075.6	2 358.1	2 545.9	2 918.4	3 177.0	4 132.0	4 747.1	4 858.3	5 429.3	7 085.6	13 831.7	13 074.7	15 365.7
Memorandum items:															
Monetary base			2 147.5	2 684.5	2 764.1	2 977.1	3 576.1	4 592.2	4 521.5	4 991.5	5 615.9	7 104.7	6 736.6	7 891.4	11 200.2
Reference exchange rate (L/$)	1 650.0	1 677.0	1 756.0	1 767.0	1 847.0	1 975.0	2 128.0	2 558.0	2 872.6	2 988.0	3 201.2	3 733.9	7 235.9	7 172.3	7 528.8
Gross foreign assets	2 852.6	4 475.0	4 942.4	5 490.4	5 323.1	5 628.8	5 159.7	6 263.8	6 666.8	7 954.6	7 832.3	12 195.6	17 160.9	23 517.7	32 303.3
Forex deposits in % of M2	33.9	28.1	25.8	22.1	22.7	22.9	21.7	22.6	24.5	22.7	22.5	23.4	36.5	29.7	29.8

Source: National Bank of Romania.

Table A11. **General government consolidated budget 1997**

Billions of lei

	State budget	Local Budget	State social security budget	Supple-mentary pension fund	Unem-ployment fund	Health fund	Farmers' social security fund	Risk and accident fund	Special funds[1]	External loans to ministries	SOF	Consolidated general government budget	In percentage of GDP 1997	In percentage of GDP 1996
Total revenue	**41 214.2**	**10 117.3**	**12 496.3**	**1 758.8**	**3 552.2**	**1 349.5**	**1 833.8**	**686.7**	**3 779**		**3 859**	**72 786.5**	**27**	**30.4**
Current revenue	39 407.2	6 027.4	11 091.1	1 758.8	3 472.2	1 349.5	810	361.1	3 779		3 859	**71 920.5**	**26.7**	**30.2**
Tax	38 083.9	5 739.5	10 949.1	1 464.6	2 685.2	1 121.7	805	368.2	3 674			**64 888.4**	**24.1**	**27.7**
Direct tax	17 519.5	5 661.5	10 949.1	1 464.6	2 685.2	1 086.7	805	368.2				**40 537**	**15**	**18.5**
Profit tax	8 966.5	103.5										**9 070**	**3.4**	**3.2**
Tax on salaries	8 146.2	4 503.8										**12 650**	**4.7**	**5.9**
Social security contributions			10 949.1	1 464.6	2 685.2	1 086.7	12.5					**16 195.3**	**6**	**8.5**
Economic unit contributions							792.5	368.2				**1 160.7**	**0.4**	**0.6**
Other	406.8	644.4										**1 051.2**	**0.4**	**1**
Indirect tax	20 564.4	78				35			3 674			**24 351.4**	**9**	**9.2**
Excises and oil tax	4 959.8											**4 959.8**	**1.8**	**1.4**
VAT	11 805.8											**11 805.8**	**4.4**	**4.9**
Customs duties	3 524.3											**3 524.3**	**1.3**	**1.7**
Other	274.5	78				35			3 674			**4 061.5**	**1.5**	**1.3**
Non tax	1 323.3	287.9	142	294.2	787	227.8	5	0.9	105		3 859	**7 032.1**	**2.6**	**2.5**
Capital	1 803	56.1										**782.1**	**0.3**	**0.2**
Subsidies from state budget		4 033.8	1 392.8				1 023.8	317.6						
Receipts from repayment of loans	4		12.4		80							**84**	**0**	**0.1**

Table A11. **General government consolidated budget 1997** *(cont.)*

Billions of lei

	State budget	Local Budget	State social security budget	Supple-mentary pension fund	Unem-ployment fund	Health fund	Farmers' social security fund	Risk and accident fund	Special funds[1]	External loans to ministries	SOF	Consolidated general government budget	In percentage of GDP	
													1997	1996
Total expenditure	**54 619.7**	**10 117.3**	**12 496.3**	**1 640.3**	**2 898.8**	**1 349.5**	**1 833.8**	**686.7**	**2 961.9**	**2 350.4**	**3 015**	**84 923.6**	**31.5**	**34.4**
Public authorities	1935.3	945										**2 869.1**	**1.1**	**1.1**
Defense	4 526									168.7		**4 313.1**	**1.6**	**1.9**
Public order and national safety	2 600.8									196		**2 750.6**	**1**	**1.4**
Education	7 680.6	1 462.7			20.7					189.3		**9 353.3**	**3.5**	**3.5**
Health	4 307	2 237.5				908.5				459.4		**7 673.7**	**2.8**	**2.9**
Culture, religion, sport, youth	776.8	538.1										**1 314.9**	**0.5**	**0.5**
Social welfare, children allowances, pensions	5 385.5	1 422.2	12 199.3	1 599.7	2 653.4		1 765.1	308.2		8.2		**25 322.6**	**9.4**	**9**
Other social expenditures						441	2.8	354.1				**795.1**	**0.3**	**0.4**
Community amenity affairs, housing	415.5	2 169.5										**2 585**	**1**	**1.9**
Environment and water	145.3											**145.3**	**0.1**	**0.2**
Industry	1 702								1 064	12.3		**2 615.8**	**1**	**2.3**
Agriculture, forestry	3 725.3											**3 706**	**1.4**	**2.4**
Transportation, Communication	1 735.8	1 158.8							1 735	1 279.4		**5 731.7**	**2.1**	**2.3**
Other economic affairs and services	467.2								5		3 015	**2 249.8**	**0.8**	**1.1**
Research	804.3											**804.3**	**0.3**	**0.4**
Other expenditure	271.6	115.6	297	40.6	144.7		65.9	24.4	175.9	37.1		**1 172.8**	**0.4**	**0.5**
Transfers	6 768.1													**0.3**
Interest payments from public debt	9 734.2	4.4										**9 738.6**	**3.6**	**1.6**
Reserve fund	138.6											**138.6**	**0.1**	**0**
Lending	1 499.8				80							**1 579.8**	**0.6**	**0.4**
Excedent/deficit	–13 405.5			118.5	653.4				817.1	–2 350.4	844	**–12 137.1**	**–4.5**	**–3.9**

1. Includes special funds for custom, energy systems, roads and protection of insured persons.

Source: Ministry of Finance.

Table A12. **Selected demographic and social indicators**

	1980	1985	1990	1991	1992	1993	1994	1995
GDP per capita (US$, current exchange rate)	2 446	1 337	1 648	1 244	859	1 158	1 323	1 573
GDP per capita (US$, PPP)			3 979	3 717	3 542	3 698	3 931	4 312
Population characteristics								
Total population (mn at 1 July)	22.2	22.7	23.2	23.2	22.8	22.8	22.7	22.7
Population growth rate	0.7	0.4	0.4	–0.1	–1.7	–0.1	–0.1	–0.2
Number of employed persons (mn)	10.4	10.6	10.8	10.8	10.5	10.1	10.0	9.5
Population urban (% of total)	45.8	50.0	54.3	54.1	54.3	54.5	54.7	54.9
Population density per km^2	93.1	95.3	97.3	97.3	95.6	95.5	95.4	95.1
Agricultural area (% of total)			62.0	62.1	62.0	62.1	62.1	62.1
Life expectancy at birth[1]								
Women	71.8	72.7	72.7	73.1	73.2	73.2	73.3	73.4
Men	66.7	66.8	66.6	66.6	66.6	66.1	65.9	65.7
Live births (per 1 000 inhabitants)	18.0	15.8	13.6	11.9	11.4	11.0	10.9	10.4
Infant mortality (under 1 year, per 1 000 live births)	29.3	25.6	26.9	22.7	23.3	23.3	23.9	21.2
Population death rate (per 1 000 inhabitants)	10.4	10.9	10.6	10.9	11.6	11.6	11.7	12.0
Food, health and nutrition								
Calorie intake (calories per day)	3 259	3 057	3 038	2 832	2 758	2 959	2 872	2 908
Population per physician (excl. dentists)	678	567	555	551	536	565	567	565
Population per dentist			3 456	3 589	3 511	3 597	3 844	3 751
Population per pharmacist			3 692	4 564	5 970	8 156	8 078	8 523
Population per hospital bed	114	112	112	112	127	127	130	131
Access to safe water (% of pop.)								
Rural			16					
Urban			100					
			1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
Education								
Percentage of population between 15 and 18 years in school			90.7	76.1	67	63.7	68.9	59.7
Secondary school enrolment (per cent)			91.4	88.8	86.1	86.5	84.6	92.8
Primary school enrolment (per cent)			90.9	92.4	93.8	96.9	99.4	96.9

1. Average of three years to date.

Source: National Commission for Statistics.

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Czech Republic	Denmark	Finland	France	Germany	Greece
Population												
Total	Thousands	1995	18 054	8 047	10 137	29 606	10 331	5 228	5 108	58 141	81 662	10 459
Inhabitants per sq. km	Number	1995	2	96	332	3	131	121	15	106	229	79
Net average annual increase over previous 10 years	%	1995	1.4	0.6	0.3	1.3	0	0.2	0.4	0.5	3	0.5
Employment												
Total civilian employment (TCE)[2]	Thousands	1994	7 943	3 737	3 692 (93)	13 292	4 932	2 508	2 015	21 744	35 894	3 790
of which: Agriculture	% of TCE	1994	5.1	7.2	2.6 (92)	4.1	7	5.1	8.3	5.1 (93)	3.3	20.8
Industry	% of TCE	1994	23.5	33.2	27.7 (92)	22.6	42.9	26.8	26.8	27.8 (93)	37.6	23.6
Services	% of TCE	1994	71.4	59.6	69.7 (92)	73.3	50.1	68.1	64.9	67.3 (93)	59.1	55.5
Gross domestic product (GDP)												
At current prices and current exchange rates	Bill. US$	1995	360.3	233.3	269.2	560	45.7	173.3	125	1 537.6	2 412.5	77.8 (94)
Per capita	US$	1995	19 957	28 997	26 556	18 915	4 420	33 144	24 467	26 445	29 542	7 458 (94)
At current prices using current PPP's[3]	Bill. US$	1995	349.4	167.2	210.8	622.6	..	112.6	90.9	1 159.3	1 673.8	127.3
Per capita	US$	1995	19 354	20 773	20 792	21 031	..	21 529	17 787	19 939	20 497	12 174
Average annual volume growth over previous 5 years	%	1995	3.3	2	1.2	1.5	..	2	–0.7	1.1	1.7	0.8 (94)
Gross fixed capital formation (GFCF)	% of GDP	1995	20.1	24.7	17.6	17.5	32.2	16	15.1	18	21.7	16.9 (94)
of which: Machinery and equipment	% of GDP	1995	10.5 (94)	9 (94)	7.4 (94)	6.5	..	7.2 (94)	5.9 (94)	8.1	7.6	7.9 (94)
Residential construction	% of GDP	1995	5.6 (94)	6.4 (94)	4.5 (94)	4.9	..	3 (94)	3.6 (94)	4.5	7.6	3.4 (94)
Average annual volume growth over previous 5 years	%	1995	3	3	–1.1	0.3	..	–0.5	–10.4	–1.3	2.5	1.2 (94)
Gross saving ratio[4]	% of GDP	1995	16.9	24.9	22.6	17.1	..	17.8	19.8	19.7	21.3	15.7 (94)
General government												
Current expenditure on goods and services	% of GDP	1995	17.2	18.9	14.8	19.6	..	25.1	21.8	19.3	19.5	18.5 (94)
Current disbursements[5]	% of GDP	1994	36.2	47.8	54.1	46.7	..	61.1	57.7	50.9	46.1	52.7
Current receipts	% of GDP	1994	34.2	47.3	50.6	42.4	..	59.1	53	46.4	46.4	44.2
Net official development assistance	% of GNP	1994	0.33	0.33	0.32	0.42	..	0.99	0.3	0.64	0.33	..
Indicators of living standards												
Private consumption per capita using current PPP's[3]	US$	1995	12 090	11 477	12 960	12 551	10 259	11 531	9 643	11 996	11 707	9 071
Passenger cars, per 1 000 inhabitants	Number	1993	438	418	402	455 (92)	164	312	367	419	533[8]	187
Telephones, per 1 000 inhabitants	Number	1992	482	451	437	592	190	589	544	536	457[8]	457
Television sets, per 1 000 inhabitants	Number	1992	482	480	453	640	..	537	505	408	558	201
Doctors, per 1 000 inhabitants	Number	1994	2.2 (91)	2.4	3.7	2.2	3.2	2.8 (93)	2.7	2.9	3.2 (92)	3.9 (93)
Infant mortality per 1 000 live births	Number	1994	5.9	6.3	7.6	6.8 (93)	..	5.4 (93)	4.6	6.1	5.8 (93)	7.9
Wages and prices (average annual increase over previous 5 years)												
Wages (earnings or rates according to availability)	%	1995	2	5	2.8	2.7	..	3.3	4.2	3	4.8	13.4
Consumer prices	%	1995	2.5	3.2	2.4	2.2	20.3	2	2.3	2.2	3.5	13.9
Foreign trade												
Exports of goods, fob*	Mill. US$	1995	53 092	57 200	170 230[7]	192 502	21 654	49 045	39 995	286 762	523 000	11 761
As % of GDP	%	1995	14.7	24.5	63.2	34.4	47.4	28.3	32	18.7	21.7	12.2 (94)
Average annual increase over previous 5 years	%	1995	6	6.9	7.6	8.6	..	7	8.6	5.8	5	8
Imports of goods, cif*	Mill. US$	1995	57 406	65 293	155 449[7]	164 443	26 523	43 728	28 928	267 059	463 472	27 718
As % of GDP	%	1995	15.9	28	57.7	29.4	58	25.2	23.1	17.4	19.2	28.3 (94)
Average annual increase over previous 5 years	%	1995	8.1	5.9	5.3	7.1	..	6.7	1.4	3.5	6.1	6.9
Total official reserves[6]	Mill. SDRs	1995	8 003	12 600	10 883[7]	10 124	9 312	7 411	6 753	18 065	57 185	9 943
As ratio of average monthly imports of goods	Ratio	1995	1.7	2.3	0.8	0.7	..	2	2.8	0.8	1.5	4.3

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period[1]	Hungary	Iceland	Ireland	Italy	Japan	Korea	Luxembourg	Mexico	Netherlands	New Zealand
Population												
Total	Thousands	1995	10 229	267	3 580	57 283	125 250	44 851	413	91 120	15 457	3 580
Inhabitants per sq. km	Number	1995	111	3	51	190	332	444	159	46	379	13
Net average annual increase over previous 10 years	%	1995	–0.3	1	0.1	0	0.4	0.9	1.2	2.1	0.7	0.9
Employment												
Total civilian employment (TCE)[2]	Thousands	1994	3 643	138	1 207	20 022	64 530	19 831	207	32 439	6 631	1 560
of which: Agriculture	% of TCE	1994	9	9.4	12	7.7	5.8	13.6	2.9	25.8	4	10.4
Industry	% of TCE	1995	34	26.1	27.6	32.1	34	33.2	30.7 (90)	22.2	23	24.9
Services	% of TCE	1995	57.1	65.2	60.5	60.2	60.2	53.2	66.1 (90)	52.1	73	64.6
Gross domestic product (GDP)												
At current prices and current exchange rates	Bill. US$	1995	43.7	7	64.3	1 087.2	5 114	455.5	10.6 (92)	246.1	395.5	59.7
Per capita	US$	1995	4 273	23 366	17 965	18 984	40 726	10 155	26 866 (92)	2 597	25 597	16 689
At current prices using current PPP's[3]	Bill. US$	1995	..	5.9	61.7	1 114.7	2 736.8	..	12.8	699.7	305.6	60.3
Per capita	US$	1995	..	21 938	17 228	19 465	21 795	..	31 303	7 383	19 782	16 851
Average annual volume growth over previous 5 years	%	1995	..	0.9	5.7	1.1	1.3	..	4.1 (92)	3.0 (93)	2.1	2.9
Gross fixed capital formation (GFCF)	% of GDP	1995	19.3	15.2	15.1	17	28.5	36.6	27.7 (92)	16.6	19.4	20.5
of which: Machinery and equipment	% of GDP	1993	8	4.7	5.5	8.6	9.6 (94)	13.2	..	9.4 (93)	9.1	10
Residential construction	% of GDP	1993	9.8	4	5	4.8	5.7 (94)	7.8	..	4.9 (93)	5.2	5.5
Average annual volume growth over previous 5 years	%	1995	..	–4.1	0.9	–1.7	–0.1	..	6.5 (92)	7.7 (94)	1.2	4.5
Gross saving ratio[4]	% of GDP	1995	..	16.4	19.5	20.5	30.8	35.8	60.2 (92)	15.1 (94)	24.6	18.4
General government												
Current expenditure on goods and services	% of GDP	1995	24.9	20.8	14.7	16.3	9.7	10.4	17.1 (92)	10.6[7]	14.3	14.3
Current disbursements[5]	% of GDP	1994	..	34.4	40.4 (93)	51	27	15.3	..	..	52.8	..
Current receipts	% of GDP	1994	..	35.4	38.9 (93)	45	32.2	24.2	..	..	51.6	..
Net official development assistance	% of GNP	1994	..	..	0.2	0.27	0.28	..	0.4	..	0.75	0.22
Indicators of living standards												
Private consumption per capita using current PPP's[3]	US$	1995	11 197	13 208	9 467	11 952	13 102	12 287	16 827	5 368	11 854	10 396
Passenger cars, per 1 000 inhabitants	Number	1993	204	435	251	516 (92)	326	95	506	88	372	439
Telephones, per 1 000 inhabitants	Number	1993	146	544	328	418	468	378	541	88	499	460
Television sets, per 1 000 inhabitants	Number	1992	414	319	304	421	614	211	267	149	488	443
Doctors, per 1 000 inhabitants	Number	1994	..	3 (93)	2	1.7 (92)	1.8	..	2.2 (93)	1	2.5 (90)	2.1
Infant mortality per 1 000 live births	Number	1994	11.5	4.8 (93)	5.9	7.3 (93)	4.2	..	8.5 (92)	17	5.6	7.3 (93)
Wages and prices (average annual increase over previous 5 years)												
Wages (earnings or rates according to availability)	%	1995	..	..	4.3	5	2	..	..	1.9	2.9	1.6
Consumer prices	%	1995	25.4	3.5	2.5	5	1.4	6.2	2.8	17.6	2.7	2.1
Foreign trade												
Exports of goods, fob*	Mill. US$	1995	12 540	1 802	44 708	233 868	441 512	125 058	..	79 542	197 087	13 805
As % of GDP	%	1995	28.7	25.6	69.5	21.5	8.6	27.5	..	32.3	49.8	23.1
Average annual increase over previous 5 years	%	1995	5.2	2.5	13.4	6.6	9	14	..	24.3	8.5	7.9
Imports of goods, cif*	Mill. US$	1995	15 073	1 754	33 024	206 246	335 392	135 119	..	72 453	177 912	13 990
As % of GDP	%	1995	34.5	24.9	51.3	19	6.6	29.7	..	29.4	45	23.4
Average annual increase over previous 5 years	%	1995	11.7	1.2	9.8	2.5	7.5	14.1	..	18.3	7.1	8.1
Total official reserves[6]	Mill. SDRs	1995	8 108	207	5 806	23 482	123 277	21 983	..	11 333	22 680	2 967
As ratio of average monthly imports of goods	Ratio	1995	..	1.4	2.1	1.4	4.4	..	..	1.9	1.5	2.5

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Refers to the public sector including public enterprises.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period[1]	Norway	Poland	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population											
Total	Thousands	1995	4 360	38 588	9 921	39 210	8 827	7 081	61 644	58 613	263 058
Inhabitants per sq. km	Number	1995	13	119	107	78	20	171	79	239	28
Net average annual increase over previous 10 years	%	1995	0.5	0.4	–0.1	0.2	0.6	0.8	2.1	0.3	1
Employment											
Total civilian employment (TCE)[2]	Thousands	1994	2 003	14 658	4 372	11 760	3 926	3 772	19 664	25 579	123 060
of which: Agriculture	% of TCE	1994	5.3	23.8	11.5	9.8	3.4	4	44.8	2.1	2.9
Industry	% of TCE	1994	23.4	31.9	32.8	30.1	25	28.8	22.2	27.7	24
Services	% of TCE	1994	71.3	44.1	55.7	60.2	71.6	67.3	33	70.2	73.1
Gross domestic product (GDP)											
At current prices and current exchange rates	Bill. US$	1995	103.4 (93)	118	99.8	559.6	230.6	306.1	169.3	1 101.8	6 954.8
Per capita	US$	1995	23 984 (93)	3 057	10 060	14 272	26 096	43 233	2 747	18 799	26 438
At current prices using current PPP's[3]	Bill. US$	1995	98.8	..	123.5	557.8	165	175.7	350.8	1 041.9	6 954.8
Per capita	US$	1995	22 672	..	12 457	14 226	18 673	24 809	5 691	17 776	26 438
Average annual volume growth over previous 5 years	%	1995	2.1 (93)	..	1.4	1.3	0.4	0	3.2	1.2	2.3
Gross fixed capital formation (GFCF)	% of GDP	1995	22 (93)	17.1	23.7	20.6	14.5	22.7	23.3	15.1	17.6
of which: Machinery and equipment	% of GDP	1995	..	..	11.7 (93)	5.8 (94)	7.8	8.3	10.8	7.3 (94)	7.7 (93)
Residential construction	% of GDP	1995	..	..	5.2 (93)	4.1 (94)	1.6	14.4[7]	9.3 (94)	3.1 (94)	4.0 (93)
Average annual volume growth over previous 5 years	%	1995	–3.3 (93)	..	1.8	–0.9	–5.3	–0.2	4	–1.6	5.8
Gross saving ratio[4]	% of GDP	1995	21.9 (93)	..	21.6	21.5	16.6	30.1	19.7	13.8	15.9
General government											
Current expenditure on goods and services	% of GDP	1995	22.1 (93)	..	18.1	16.6	25.8	14	10.8	21.4	16.2
Current disbursements[5]	% of GDP	1994	..	..	42.5 (93)	42.6	66.4	36.8.	..	42.3	35.8 (93)
Current receipts	% of GDP	1994	..	..	39.8 (93)	39.1	57.4	36.6	..	37.3	31.7 (93)
Net official development assistance	% of GNP	1994	1.05	..	0.36	0.27	0.92	0.38	..	0.31	0.15
Indicators of living standards											
Private consumption per capita using current PPP's[3]	US$	1995	11 194	..	8 150	8 812	9 778	14 594	4 021	11 319	17 834
Passenger cars, per 1 000 inhabitants	Number	1993	375	175	332	343	404	440	43	375 (92)	556
Telephones, per 1 000 inhabitants	Number	1993	542	115	311	364	678	611	184	494	574
Television sets, per 1 000 inhabitants	Number	1992	424	295	188	402	469	407	176	435	815
Doctors, per 1 000 inhabitants	Number	1994	3.3 (93)	..	2.9	4.1 (93)	3	3.1	1.1	1.5 (93)	2.5 (93)
Infant mortality per 1 000 live births	Number	1994	5.1 (93)	..	7.9	7.6 (93)	4.8 (93)	5.6 (93)	46.8	6.2	8.5 (92)
Wages and prices (average annual increase over previous 5 years)											
Wages (earnings or rates according to availability)	%	1995	3.5	..	..	6.4	4.6	..	..	5.7	2.7
Consumer prices	%	1995	2.4	43	7.2	5.2	4.4	3.2	78.6	3.4	3.1
Foreign trade											
Exports of goods, fob*	Mill. US$	1995	41 836	22 892	23 356	91 615	79 595	81 499	21 853	242 692	584 742
As % of GDP	%	1995	30.9 (93)	19.4	23.4	16.4	34.5	26.6	12.9	22	8.4
Average annual increase over previous 5 years	%	1995	4.4	..	7.4	10.6	6.7	5	10.8	5.7	8.2
Imports of goods, cif*	Mill. US$	1995	32 804	29 050	33 539	114 835	64 469	80 193	36 060	265 696	743 445
As % of GDP	%	1995	23.3 (93)	24.6	33.6	20.5	28	26.2	21.3	24.1	10.7
Average annual increase over previous 5 years	%	1995	3.8	..	6.2	5.6	3.3	2.8	9.8	3.5	8.5
Total official reserves[6]	Mill. SDRs	1995	15 148	9 939	10 663	23 199	16 180	24 496	8 370	28 265	50 307
As ratio of average monthly imports of goods	Ratio	1995	5.5	..	3.8	2.4	3	3.7	2.8	1.3	0.8

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics.*

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