

Policy Warning Report

edited by

Romanian Academic Society (SAR)



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POLICY WARNING REPORT (PWR) - ROMANIA
ROMANIAN ACADEMIC SOCIETY (SAR)

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SELECTED INDICATORS

	Q1 2002	Q2 2002	Q3 2002	Q4 2002	Year 2002	Q1 2003	Q2 2003	Jul 2003	Aug 2003	Trend 2003
GDP growth (quarterly, annualized), %	3.1	5.7	4.5		4.9	4.4				↗
Exchange rate Leu/USD, total interval, %	4.1	1.8	-1.1	1.3	6.02	-0.93	-0.53	-0.67		↘
Inflation, monthly average, %	3.9	5.1	2	6	17.8	1.3	0.8			↘
Industrial output, monthly average %	4.4	4.2	6.9	8.3	6.0	3.4	2.9			↗
Trade deficit, FOB/CIF (million USD)	759	1,003	948	1,279	3,988	820	1,748			↗
Unemployment rate, %	13	9.6	8.2	8.1	8.1	8.3	8.1	6.9		↘
Average net monthly salary, USD	110	118	118	122	117	132	142			↗
State pensioners / employees	1.01	1.011	1.013	1.02		1.06	1.07			↗
Business confidence for the next 3 months: output / contracts / jobs (INSSE survey)						↗ ↗ ↘	↗ ↗ -	↗ ↗ ↗		
Trust in government, % (The current Government can improve things)	45	38	32			38	31		34	↘
Pessimism, % (Country heading in the wrong direction)	51	57	62			49	57		63	↗
Subjective welfare, % (Better off than last year)	11	12	11			15	16		16	-

Abstract

The ruling party, PSD, has abandoned its previous intentions to transform itself into a modern Social-Democratic movement – together with some of the people who were supposed to spearhead such changes, says the **Politics** section of this report. The judicial reform has not progressed significantly in the twelve months since our last assessment, and we believe this has to do primarily with a lack of political will. As for the opposition, SAR suggests that only a tight and institutionalized party union between PNL and PD will be able to make a difference in the 2004 elections.

Romania's target date of admission in the European Union is 2007. At the last summit, in Thessalonica, the EU leaders restated their encouragement and support for Romania so that the country joins the Union by 2007. Likewise, they nudged the Romanian government to pursue relentlessly the necessary reforms with regard to industrial restructuring, public administration and the judiciary system. The **Economy** section presents a succinct overview of economic developments in Romania and the immediate prospects at the end of the first half of 2003.

The data from the last year's census have unleashed a wave of public *angst* and self-doubt about the fate of the nation. The **Social** section argues that such concerns are misplaced, and that what really matters are the government policies which in the last decade have contributed much more than the natural demographic trends to the current high dependency rate, for example. It is advisable to shift government policy so as to take into account these trends, especially by introducing incentives in the social insurance system to encourage people to contribute longer and rely less on public social security.

1. POLITICS

REFORM STALLED

Government Party Slides Back To Its Ambiguous Past

Romania's government party has been engaged since 2000 in a visible effort to change its image at home and abroad. Willing to leave behind them the image of turncoat communists with barely disguised authoritarian tendencies the Social Democrats followed a twofold strategy. First, they recruited a number of technocrats in key negotiation positions with the West (ministers of Foreign Affairs, Finance, negotiator of EU accession). Second, they employed a young bureaucrat with private sector credentials (Cozmin Gușă) mandated to reform the party and transform it into a modern social-democratic movement. The authority of such people was designed to proceed from the Prime Minister, in his double capacity as a head of government and party leader. Besides this informal empowerment, none of the pro-Western actors did enjoy – or receive – real power in the party.

WARNING

While the ministers and the PM were busy with governing and Gușă with improving the party image, the networks of influence within PSD took more and more control of the party machine. Granted impunity by the premier despite credible media allegations on their corruption, the regional 'barons' of PSD have turned the organization into a collection of clans. In July they managed to oust Gușă, the secretary general, who had been instrumental in rallying a few credible opinion leaders and politicians to the government's camp. The secretary general was first offered an executive position, which would have ended his formal task of chief party reformer; when he turned it down, his office was stripped of its powers and left with ceremonial attributions only. Upon his departure, he suggested that "undemocratic" and allegedly corrupt characters like Dan Ioan Popescu, the Economy minister, Miron Mitrea, the Infrastructure minister, and Viorel Hrebenciuc, a prominent PSD parliamentarian, should also step down. Unsurprisingly, none did, despite evidence being published by the leading Romanian daily, *Adevărul*, accusing Hildegard Puwak, Minister of European Integration, of being involved in conflict of interest (both her husband and son have four companies which ran programs through the Leonardo program after she was appointed minister in early 2001).

Judicial Reform Buried in Scandal

It is not only the PSD internal restructuring which is at stake here. The reform of PSD is a private business – the reform of the country, especially in view of the EU accession, is of public interest. While the economy seems to be on the right track and the government hires lobby groups to advocate for the status of a functional market economy, signs from sensitive sectors, such as justice, raise doubt on the political will to accomplish substantive changes. A year after this report examined the reform of the judiciary the progress is meager. The draft law on the organization of the Superior Council of Magistrates (CSM), the key issue for ensuring the true independence of the judiciary, was still not made public and discussed with the civil society and international donors. Worse, the behavior of the barely renovated CSM (which produced a document in July attacking the President of the Supreme Court of Justice for 'human rights abuse', meaning the call to order of a prosecutor in a trial) shows that the Council will be allowed to gain strength only to the extent that its composition can be controlled. In effect, it will replace the Ministry of Justice as a more discrete form of political control over the judiciary.

Fig. 1. Reform of the judiciary

	Current legal situation	Current practice	Proposed reforms
<i>Extraordinary appeals against definitive sentences</i>	Possible only in criminal trials after revision of Procedures of Civil Code	156 appeals admitted in criminal law suits and 238 in civil law suits since January 1 st , 2003. ¹	Intention to keep them in criminal cases despite international disapproval
<i>Appointment of CSM</i>	Screening by Parliament of proposals after restricted vote by judges	Judges from higher Courts favored; screening by the Committees actually turned into selection; CSM rushed to endorse the position of the Ministry of Justice in recent scandals	Unknown, draft law secret, constitutional provisions vague
<i>Independence of the Supreme Court of Justice</i>	Judges six years tenure only Influence in CSM small	President of the Court under strong attack by Minister of Justice, President of the state	Judges to be granted full tenure after constitutional reform case by case when their tenure expires
<i>Enforcement of European Court of Human Rights decisions</i>	Current constitution admits international law overrides national one in human rights law	Stalling of most ruling over property (the govt lost all of them) Infringement of the ruling limiting the right of the prosecutor to decide over preventive custody (the Pantea case) in the recent 'Ciucă' scandal.	Constitutional proposal limits application of international law if it is different than constitution, requiring its modification first; constitution can be modified only with 2/3rds majority and referendum

¹ Source: Apador- Romanian Helsinki Committee, quoting statistics obtained from Department of Justice on the basis of Freedom of Information Act.

There is also risk of political appointments to the new Court of Cassation, as most of the current judges will lose tenure in the next two years. The political signals are ambiguous, as hastily conceived legal acts are passed overnight, more often than not through emergency ordinances, while actual practices that blatantly contradict them continue unabated.

Fig. 1 makes clear the distance between proposed reforms and current practice, as the latter is the best indicator of the real political intentions. Where there is no will, there is no way, could well be its summary. Newspapers were flooded during the summer months by scandals engulfing these issues. While the official policy – for international consumption – is to abolish extraordinary appeals, the number accepted this year shows a strong political determination to keep them. The extraordinary appeal may be a powerful weapon in case a corruption trial goes wrong, a political opponent is set free or a client is sentenced. The General Prosecutor appeals very often, hurting the already low authority of the judiciary and sending the signal that a trial is over only when a politically convenient result is achieved. Judges from the Supreme Court who reversed original sentences after extraordinary appeals following political pressure and had meanwhile had their sentences invalidated by the European Courts of Human Rights should be reprimanded. Instead, they are promoted in the Department of Justice, CSM or awarded state medals².

**Judicial reform:
where there is
no will, there is
no way**

Cabinet Reshuffle Leaves the Public Skeptical

Its captive rural constituency aside, PSD declines steadily in urban areas, the real indicator of political change in Romania. Two independent surveys, SAR-CURS for this PWR, and the *Barometer of Public Opinion* (BOP, sponsored by Open Society Foundation) found a significant decline in urban areas compared to last fall, despite the success of NATO accession. As stated in previous issues of our reports, NATO accession does not alter much the trends of public opinion.

Which means, however, that PSD still keeps its voters from the 2000 elections. Its much higher figures when party preference is tested are due to severe underestimation of votes for small parties (3% in surveys compared to 12% in last elections) and extremely high rate of abstention (55.4%). In absolute figures, the government party has about the same slice as in 2000. But the erosion in urban areas is significant, and bound to continue. As we can see in Fig. 3, PSD is less likely to be supported by the young and the urban inhabitants, but also by people who are disillusioned with the direction the country is heading (who have reached 62.5% and growing). Those make over 50% of the electorate, of which 15% still would vote for PSD (representing 38% of their constituency!). This group is likely to desert the government party to search for an alternative unless something radical is done to assure them the direction has changed.

² The case of judge Ivanov, reported by *Adevarul*, www.adevarulonline.ro

PSD is continuously losing young and urban voters

By contrast, the large number of voters who would refrain from voting or declare themselves undecided (44%) does not carry great potential for a shift in party preference. The relative majority of them (38%) would in fact prefer to have only one political party: these are the disillusioned authoritarians. Were they to vote, they would likely vote for a radical populist alternative, so the fact that they do not plan to vote at all is not such bad news. Mobilizing the democrats within this group remains an issue, but they are not likely to be mobilized by any current alternative: they are demobilized precisely because they perceive the current offer of parties as unappealing.

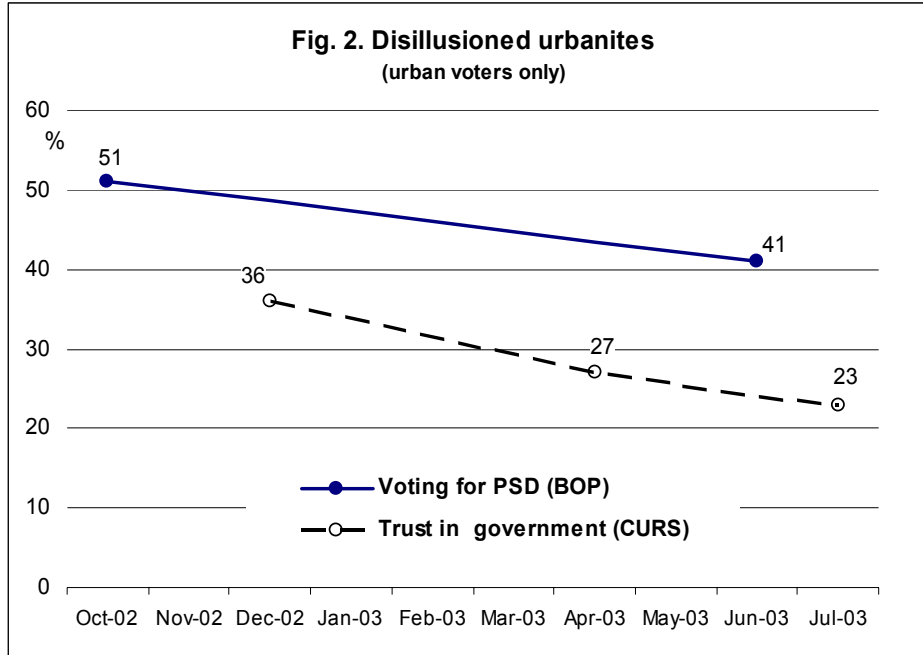


Fig. 3. Who would (not) vote for the government party

Predictors of vote for PSD	Regression coefficient B	Standard error	Significance
Age under 35	-.555	.156	.000
Education	--	--	NS
Larger than village	-.690	.238	.000
Direction wrong	-.766	.139	.000
Constant	-.716	.276	.009

Source: BOP Gallup

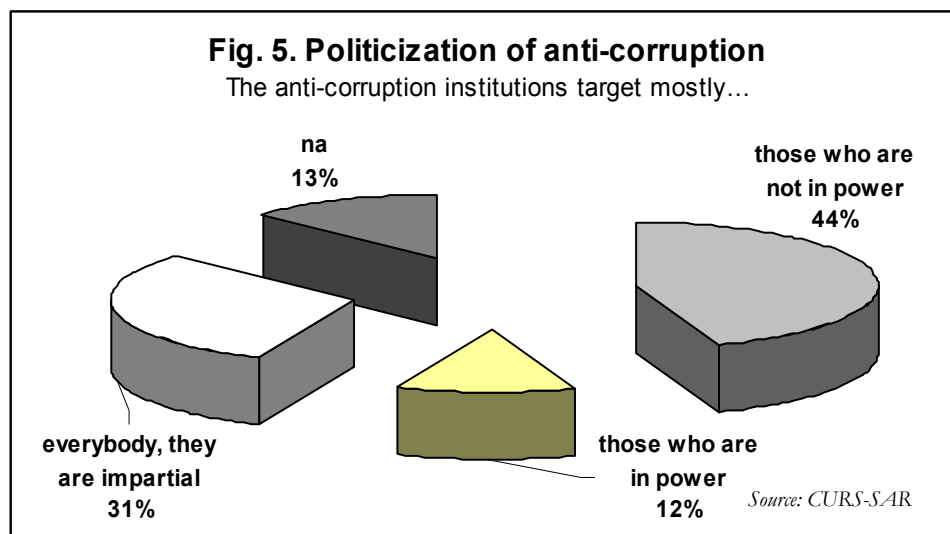
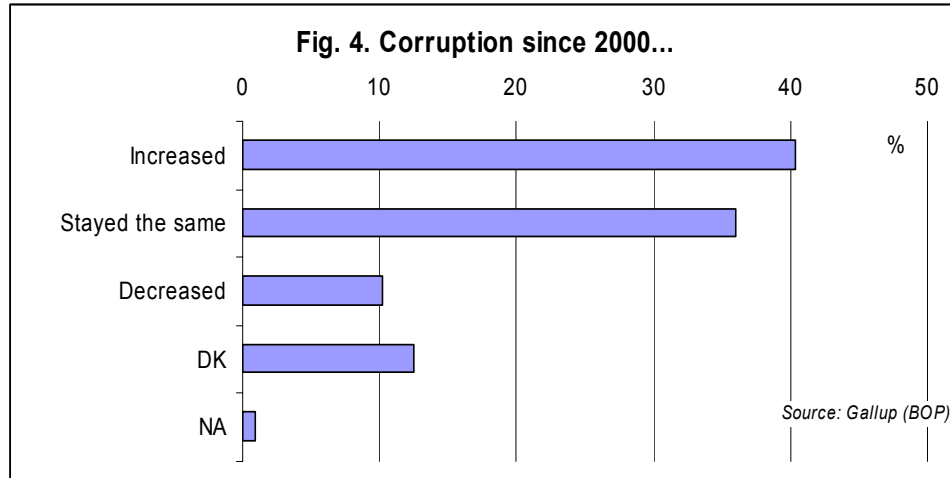
The government proceeded in June 2003 to the reshuffle this report advocated a year ago. However, what SAR had argued for was a reshuffle based on the need to streamline the decision-making, increase policy coherence, to eliminate overlaps and redundancies of the central administration units. Evaluations of effectiveness of various compartments and ministers were available at the time of this exercise. However, very few, if any, seem to have been used. How can

one even invoke policy coherence when THREE different offices have come under the last reshuffle under direct PM subordination, all with the same task of policy analysis and design? The first is what is left of the former Ministry of Information stripped of minorities and Roma departments; the second the National Commission or Prognosis, a leftover from the Minister of Prognosis and Development; and the third, the old Department for Institutional and Social Analysis, an almost informal unit working for the PM's main (foreign) economic advisor. In practice none of them does what they are supposed to do, and as a result is still left to the ministries to design broad policies. No unit is empowered with the explicit task to coordinate among ministries or produce clear guidelines for policy. This complicated design reflects only the need to satisfy various power stakeholders. One would in vain search for a correlation between the ministers reshuffled and an evaluation of their performance, either personal or institutional. True, Dan Matei Agathon was dismissed; but subsequently this former Minister of Tourism and author of the unpopular project Dracula Park was promoted party spokesperson. The ministers of Health and Education were also changed: but the Ministers of Justice and Industry, with even more doubtful performances and ratings, stayed. In the end, tenure seems to correlate only with the strength of personal links to either President or Prime Minister. Little surprise, then, that both the media and the public perceived this reshuffling as barely a makeup for the Thessalonica European Council Summit.

The government party missed therefore the reshuffle as an opportunity to persuade both the domestic and international public opinion that this move was meant to improve performance in view of the hard task to conclude negotiations for European accession by end 2004. However, nobody from the other parties seems to take advantage of this situation, as the Romanian opposition is weak and fragmented. The political spectrum remains therefore severely unbalanced. By the next 2004-2005 elections Romania will have eleven out of fifteen years of transition dominated by the main postcommunist party, now called PSD, with the other four ruled by a broad coalition of anticommunists and postcommunists. This misbalance explains by itself some of Romania's problems in tackling corruption and achieving government performance. *As recent scholarly work proved³, performance of the state in East Central Europe is less influenced by size of the government and type of previous Communist regime, as by the pattern of political competition during transition.* Romania's pattern of one dominant party-political clique is the worst. The public perceives it: a sizable majority believes that seats in Parliament are bought, corruption went up after the last change of government. The MPs are rated as the most corrupt social group in Romania. The SAR-CURS public opinion survey also shows that the public is not convinced by the government anti-corruption campaign, perceived as being partisan and ineffective by the majority of the Romanians (Fig. 5)

Members of the Parliament are perceived as the most corrupt social group in Romania

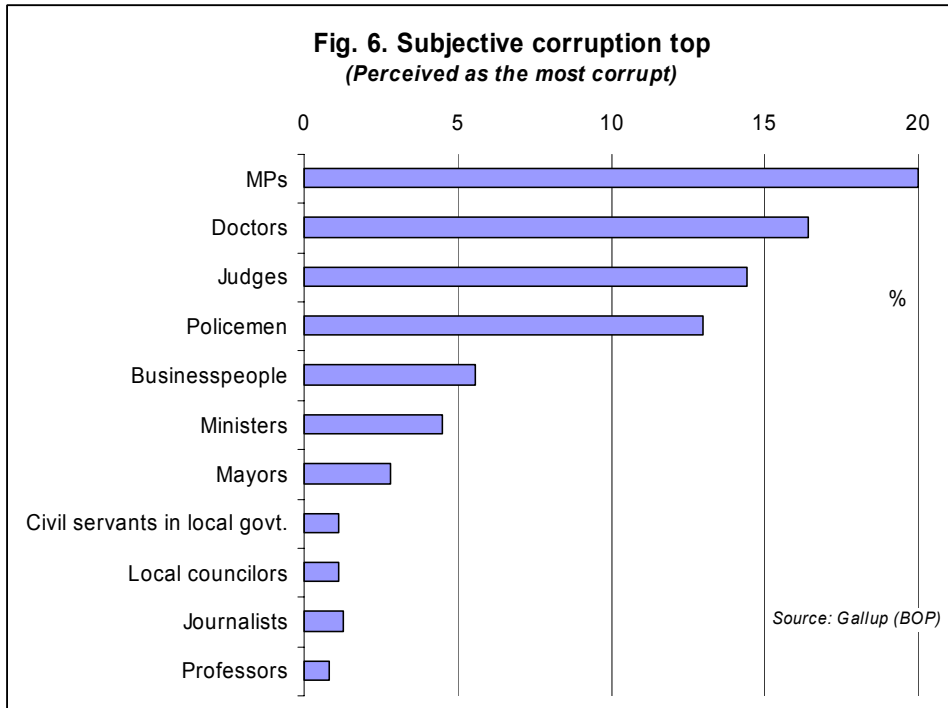
³ Anna Gryzmala Busse, Yale University. Party Competitions and State Institutions in East Central Europe, paper presented at *Strengthening States, Consolidating Democracies*, Bluebird workshop, European University Institute, May 16-17, 2003



The Anti-Corruption Chief Prosecutor should be appointed jointly by government and the opposition

In fact, this campaign is ineffective *because* it is partisan: how can the public be convinced of the impartiality of the still young Anti-Corruption Prosecutor's Office when the only politicians investigated are former and current opposition leaders? In a move which can only destroy any credibility of this office, investigations were reopened on the old file 'Privatization of the Commercial Fleet', said to incriminate the main opposition leader, Bucharest's Mayor Traian Băsescu, former minister of Transportation. The case was however investigated prior to 1996, when the same party as today was in government. At the time both an ad-hoc parliamentary committee and the prosecutors decided there were no elements to prosecute Băsescu, who was the only Romanian politician to give up his immunity as a MP in order to stand investigation. Reopening this file without even the claim of new elements after eight years cannot but show that any anticorruption agency where the leadership is politically appointed cannot but fail miserably. As this report has warned a year ago, only a joint nomination by government and opposition of the anti-corruption prosecutor could eventually work in Romania.

The police has also provoked a scandal in July when it published its personal top of corruption, which candidly showed they arrest mostly professors and doctors, shielding their own as well as persons with political clout. The public opinion blames in fact policemen, judges and politicians in its own – quite different – top.



A Workable Political Alternative Is Not Yet Born

Despite the crushing defeat of the former coalition parties in the 2000 elections, the years since were not used for any meaningful political construction. The Christian Democrats underwent a series of splits and mergers to end up in sheer obscurity. The Liberals (PNL) changed first their ancient President, Mircea Ionescu-Quintus, with Valeriu Stoica. Although Mr. Quintus was proven a collaborator of the former Securitate, parting with him was no soul-searching experience: indeed, most of the party seemed closer to him still than to the new leader. Stoica was the only one to push for a new political construction. It was precisely because of his plans to make again an alliance with the former coalition partners the Democrats (PD) that he lost power and only managed to secure some influence on the choice of his successor, Theodor Stolojan. Mr. Stolojan has tried since then to centralize the party and accommodate all factions, and recently brought up again the issue of an alliance with the Democrats. The latter had meanwhile suffered serious losses, as many of their local leaders and MPs have crossed the fence over to PSD. Few of the initial leaders the party has one been so proud of are now with Mayor Traian Băsescu, who replaced Petre Roman at the head of the party. These leaders were the largest group of technocrats in the Romanian politics

What went wrong with the previous centrist coalition?

and have embodied for many years the ideal of a new middle-aged generation in politics. Now scattered in inferior positions in both PSD and PD (some even crossed to the Liberals) they have ceased to matter at all.

Is the pre-electoral alliance of PD and PNL the political construction Romania needs to balance its party system? Would this alliance profit the Romanian democracy and the partners? Finally, is it a feasible project? And if not, what alternative is there?

Let us start with the last question. The Romanian political system could be balanced in two ways. First, by cutting the disproportioned power of one party, which used unscrupulously has meant in the last two years the recruitment of mayors elected under other parties colors, of public officials and businesspeople. This means further fragmentation, but fragmentation is at times preferable to having one dominant pole, especially in a country where state capture by networks of influence is the crucial issue. A Romania with 4-5 parties roughly the same size, forced into coalitions in order to form a government, would be better than a political landscape where one party dominates absolutely. This pattern is frequent in continental Europe. The path would have been open only if Mr. Gușă had had around him a wing of reformers from PSD willing to transform themselves into a more *Third-Way* party (as happened twice before with the split of Democrats and later of Teodor Meleșcanu). As long as Mr Gușă was just a lone reformer, or a man who simply lost in the power game, there was no chance to go down this road.

Before initiating a new coalition, PNL and PD should try to understand why the previous one (CDR) failed

The second path is by concentrating the forces of the democratic opposition into one coalition or party able to challenge PSD and win next elections. This is the path tried prior to 1996, and which produced the centrist coalition that governed between 1996 and 2000, made up of four main parties and a host of other smaller organizations. This center-right coalition produced three governments: Victor Ciorbea, Radu Vasile and Mugur Isărescu. Even if these governments had some successes in terms of structural economic reforms and decentralization, the overall coalition management, reflected in the government performance, was perceived as a failure. One serious problem burdening the design of a future coalition is the lack on any thorough analysis on the failure of the precedent one. Bad memories of these coalition governments were not completely erased by the increasing frustration with the PSD 'barons'. Nor were the issues ever clearly addressed by the former coalition leaders, so that the public can see who is to blame for what for the shortcomings of the 1996-2000 mandate. The current strategy, of putting all responsibility on the Christian Democrats, is unlikely to create a majority of supporters for Liberals and Democrats, even if the faults of Christian Democrats were real. The coalition as a whole still has to answer for the unsolved issues of the *Contract with Romania*, the failure to keep their leaders promise to boost foreign investment, the dragging of their feet in Parliament over many issues. There is a negative legacy pending on the credibility of all the former partners, and all have to come up with some

assurances that the problems were understood and addressed. Neither the Liberals, nor the Democrats, have a spotless record from the 1996-2000. A short list with the most obvious mistakes made while in power shows that responsibility must be divided between current opposition parties:

- the indefinite stalling of property restitution legislation between 1996-2000, left for the PSD next legislature (*to be blamed: the Democrats*)
- the delay of privatization of state farms (*to be blamed: the Democrats*)
- the ambiguous positions on the law on screening archives of former Securitate, leading to a poor law whose consequences are felt today in the blocking of CNSAS, the screening authority (*to be blamed: Liberals, Christian Democrats*)
- the inability to pass in 2000 the 'Justiția' legal package, crucial for Romania's reform of the judiciary and EU accession (*to be blamed: Democrats, Christian Democrats*). Romania still struggles in 2003 to reinvent one by one (and pass through emergency ordinance) the elements of the so-called 'Stoica' package.
- the inability to satisfy the basic requests of coalition agreements (eg. on Hungarian issues)
- the low performance on EU accession; for example, the inability to satisfy requirements of Schengen visa lifting procedures, fuzzy reports on the issue (*to be blamed: Christian Democrats*)
- the inability to agree on a single candidate for presidential elections, allowing Vadim Tudor, the radical party leader, to enter the second round of presidential elections (*to be blamed: all partners, including the Hungarian Alliance*).

The most serious mistakes made by CDR in 1996-2000 were...

This brief list shows that neither the principles, nor the implementation were truly satisfactory during the 1996-2000 mandate. It is true that Christian Democrats were governing for the first time, but this does not excuse the coalition as whole: Liberals and Democrats had been in government before. It is also true that during the governments of Radu Vasile and Mugur Isărescu the seeds of the present economic recovery were planted – but still, compared to the Slovak coalition which unseated Mr Meciar in 1997, the Romanian democratic parties performed very poorly. In 2000 they were not defeated, they were crushed, while the Slovaks managed to revamp their coalition, isolate Mr Meciar, and come up with a new reformist government. The performance on EU accession was far better in Slovakia compared to Romania during that time.

Due to the intrinsic checks and balances of a multi-party government, corruption in Romania was however lower in 1996-2000 than it is today. This leaves a score of issues on which the former partners need to account for if they put together a new coalition. Relying on a protest

vote against PSD is not enough. The new would-be partnership has to persuade voters that previous cacophony and ferocious partitocratic tendencies (dividing public positions among coalition parties only, regardless of merit) are a thing of the past. But are they? As negotiations progress, the same ugly ghosts raise their heads again. In fact, it may well be that a new coalition proves even worse than the previous one. Two-party coalitions are always a problem, as they push towards permanent cleavages: in three or more partners, cleavages may shift from issue to issue.

How to Design Coalitions that Work

In neighboring Bulgaria, when anticommunist UFD lost elections due to coalition problems in the early nineties, it was reorganized effectively as single party (keeping the legal identity of parties) by Ivan Kostov, who later made it to premiership. This also allowed a better performance of UNFR and persuaded voters that they were capable of change. The arguments in favor of the three existing alternatives (pre-electoral alliance; post-electoral alliance; and tight coalition, Bulgarian way) are summarized in Fig. 7. We examine the usual five crucial issues of coalition-building: decision-making, support of the government in Parliament, policy cohesion once in government, potential votes and ideological identity. The underlying assumptions are that parties which engage in negotiations seek to gain more votes and offices, win elections, form a government which has support in Parliament and a unitary policy, while preserving their identity. In practice, some trade-offs are unavoidable between party ideology and program, and the overall coalition program. Participants in coalitions must accept some blurring of identities in order to build a government with a coherent set of policies.

Fig. 7. Three types of coalition

	Decision-making after office gaining	Parliamentary support	Policy cohesion	Votes	Ideology
Pre-electoral alliance	0	0	0	0	0
Post-electoral alliance	-	-	-	-	-
Unifying coalition	+	+	+	+	0

Legend: + gains compared to present situation; - losses; 0- no change.

A post-electoral alliance of opposition parties would represent no gain. Voters would still perceive parties as unable to unite and pursuing their sole interest, programs would not be harmonized, leaving, even in the distant prospect of winning elections, each party with separate ideas and decision making fora. The exercise of harmonization would be postponed until after elections, as it happened in 1996. Needless to say, that experience was a disaster.

The pre-electoral alliance with common lists as currently negotiated would have some advantages. Liberals and Democrats would not compete unnecessarily, getting a chance to unseat Greater Romania Party from its second position. The two parties are unlikely to gain more votes than they have separately, though, as their current identity would be fully preserved, and its popularity is limited. Except some coordination and in-fighting for seats on the common lists it is unlikely that a common decision-making and a coherent program would emerge. Some coordination is better than lack of it, but examining the gains of a pre-electoral coalition one cannot fail to notice that its advantages are slim.

The only move with potential to make a difference would be the creation of a new entity, Bulgarian model, organized as one political party, with a unique chain of command at both the national and local level, a unique planning unit and policy design compartment, which would go behind the narrow ideology which voters do not care about anyway, to embrace a larger, *Third Way*-type platform. In various expressions, voters report in the polls that poverty is the main problem of Romania. When 80% of the voters are chiefly concerned with poverty, and less than 30% have a clear ideological identity (be it center-right or left) insisting on a pure 'liberal' ideology makes little sense. It would mean to confine PNL below 20% of the total pool of votes.

As this hypothetical exercise discusses mainly the Liberals and the Democrats (though other smaller parties may be involved in such a reorganization) it is also useful to check their assumed ideological distance (Fig. 8). Taking into account two items, attitude towards state intervention in economy (proxy: the creation of jobs in the public sector as main strategy against unemployment) and the attitude towards competition, we compared current voters of Democrats and Liberals. If ideology would be a scale of one to ten, the ideological distance between the voters of the two parties would be around 0.7-0.9%, i.e. less than one unit on the scale of ten. The voters the two parties risk alienating are therefore below ten percent for them together.

The secret of building successful coalitions is said to reside in the fulfillment of the self-interest of partners. Parties do not make coalitions out of their concern for the public, but out of their own interest to maximize their gains. Although this axiom relies on two disputable assumptions – that parties behave as unique actors; and that mechanisms are automatically created to help identify their best interest even in relatively new and unconsolidated parties – let us examine what parties would stand to gain or lose out of the two more plausible exercises, pre-electoral alliance or tight coalition.

If they are to stand a chance in the 2004 elections PNL and PD should form a tight Union with only one leadership, policy unit, program and electoral lists

Fig. 8. Ideological distance between the voters of PNL and PD

	PNL	PD
The state should create jobs in the public sector to cure unemployment, %	29.8	37.9
Competition is beneficial for the economy, %	86.8	76.0

Source: BOP Gallup

Fig. 9. Expected utilities for PNL and PD

		PNL		
PD	Electoral alliance	Votes	Offices	Internal cohesion
		(0,0)	(-,-)	(0,0)
	Tight coalition (union)	(+,+)	(+,+)	(-,-)

Both parties risk having internal dissent in the event of a tight coalition (union). Reorganization means that at the local level one person only is in charge of overall coordination. It does not mean, however, that party jobs are cut by half, as the parties would be reorganized in a new formula. Both reorganization and pre-electoral alliance imply common lists. In the event of a pre-electoral alliance the pool of votes may not grow more than the votes for the two parties taken separately⁴ (though they would probably score better by benefiting of the maximum utility voting, as the main opposition parties). In the event of a tight coalition presented to the voters as a new product the pool of potential votes would grow: both BOP Gallup and our survey show the potential of a unique opposition party is large. This means that both parties would stand to gain out of the union. As both have been centralized in the past year, the political will of the two leaders would suffice to realize the move. Potential splinters would not be followed by more than ten percent of the constituencies. Most likely, they would not be followed by anybody, because voters are likely to migrate towards the party ideologically closest rather than endorse splinters. For the Democrats the loss of party activists may be more dramatic than the loss of voters; but as the union would be reorganized the party activists who would desert for PSD are not really the reliable people needed to build an alternative.

But eventually the most important argument in favor of a union is that chances of a pre-electoral coalition to gain enough votes to win office are low. If this solution is preferred, gains will be small to non-significant, and the constant bickering issue by issue (should parties ally or compete for this or that office) may even deteriorate relations by the time of general elections. On the contrary, the design of a unique body where decisions are made, a policy unit and an arbitration body would anchor such issues in objective grounds. Decisions would then be based on research of potential of each candidate, leaving the

⁴ According to an *Insomar* July 2003 poll.

door open to new recruits with good public profile which would help the coalition increase its number of votes. The public wants an opposition in the form of one party (59%, CURS July 2003), with only 30% agreeing to the formula of several parties alternating to government.

The main argument against union comes from the European affiliation of these two parties. Liberals are affiliated with the Liberal International, Democrats with the Socialist International, where their presence hinders the full legitimizing of PSD in the international arena. A fusion of the two parties would be popular with the international community, but as the Liberals are unlikely to accept to move to the Socialist International it could create difficulties for the Democrats. A union in which the two parties would be reorganized as one, while keeping their legal identities separate would not create these problems. Legally the new entity would be just a coalition: the Kostov model shows however that the only coalitions effective are those organized as one party. In short, even assuming that the international affiliations of parties would have produced important gains in the past decade – in fact they have not – this is just an imagined obstacle to the creation of a union.

A union would not affect PNL and PD's membership to the Liberal and Socialist International

RECOMMENDATIONS

To the Romanian government

1. The scandal concerning Ms. Puwak, the Minister of EU Integration, is de facto covered by article 72.1 of the current law 161/2003 (Title IV, Section 2) if the article is interpreted correctly. But as European funds (and other funds from donors) are not specifically assimilated to Romanian public funds and a minister may not be hold responsible for a tender with the involvement of her department, but without her personal presence, a clearer legal provision is needed here.

Amend conflict of interest legislation with a clear article regulating public expenditure with a specific mentioning of EU funds. One single article would be enough, stating that no person working in any capacity for an authority involved in allocating or managing public is allowed to gain material profit for itself or family members out of the tenders organized by the authority. The current anticorruption package, lengthy as it is, has some good provisions, but also many loopholes.

Address the public concern over partisanship of the anticorruption campaign. Investigate the mayor of Bucharest for current wrongdoings (if any), but do not open files already closed. Charge at least now and then members of the government party, or at least expel them from the party when proved corrupt. Recent allegations against Hildegard Puwak or Miron Mitrea should not be dismissed without investigations.

2. The reform of the judiciary should be urgently brought on the right track. While reform of the civil service, at least formally, recorded

some progress, reform of the judiciary is trailing miserably behind. The laws promulgated as emergency ordinances – codes of procedure for civil and criminal courts, for instance – were all part of the 2000 package presented by the former Minister of Justice Valeriu Stoica to the Parliament at that moment. The package was drafted with international assistance and even admitting the current government wants to operate important changes there is no reason why three years later the drafts are produced one by one, and many pieces are still missing. There is no excuse for the delay and the lack of transparency of the process. Also, it is about time the extraordinary appeal and its underlying assumption, that Courts are often wrong but the government is always right, was given up entirely.

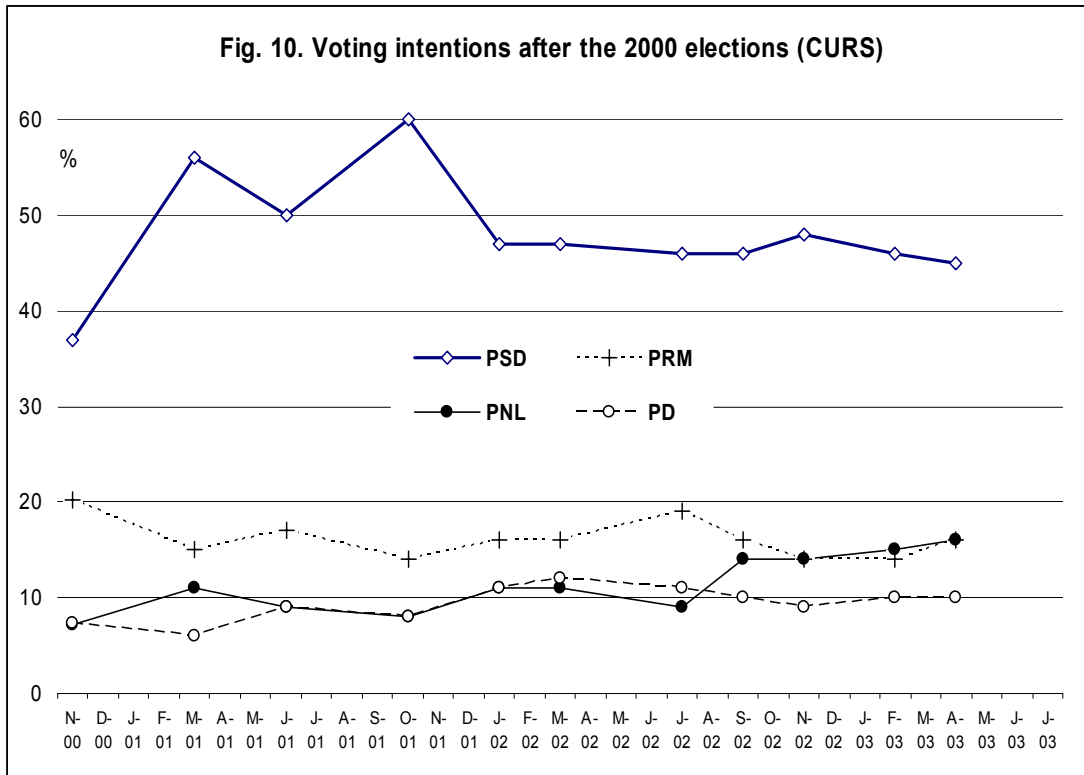
Empower the judiciary through the adoption of a CSM law liberalizing the election of its members (by giving more say to judges from lower echelons), an enhanced role to the Supreme Court, and reducing the capacity of the Parliament to revert the selection. The spirit of the Constitutional amendments is for better separation of powers; make this effective by ending the subordination of the judiciary. Abolish the extraordinary appeals and instead introduce professional evaluations of judges by the new CSM, which would make those pronouncing 'wrong' rulings pay a career cost. Give up the political reversals of rulings, or else the Romanian judiciary will never have real authority. Dismiss the personnel involved in the process of reform if deadlines are not met.

To opposition parties

When planning to create a new coalition, address the public concern that this may function as badly as the last one. If you find the political will to do it, go for the union, not the loose alliance. Coming before the public with a new construction is the only way to distance from the past coalition and its shortcomings. This will not secure electoral victory by itself, of course, but anything less will not work for certain. The challenger of PSD will have this time to show not only a clear program, but also new people, not tainted by scandals. The sooner the union presents a shadow cabinet working the more the public will be convinced this time it might work.

Decoupling presidential and parliamentary elections is a bad idea. This implies Romania would have a full electoral year (local in mid 2004, presidential in the fall, legislative in spring 2005). The uncertainty and campaigning should be reduced to a minimum not to impede Romania's EU accession. The disproportion among presidential candidates is at this time smaller than the disproportion among parties, so disjoining the legislative and presidential elections could only benefit PSD. *Opposition parties should resist suggestions from the President and/or government to disjoin presidential and parliamentary elections. By January 2005 Romania needs a new government to*

embark on the difficult task of implementing the commitments undertaken during negotiations.



2. ECONOMY

MID-2003 MACROECONOMIC HIGHLIGHTS

FOCUS

Romania's target date of admission in the European Union is 2007. At the last summit, in Thessalonica, the EU leaders restated their encouragement for and support to Romania so that it joins the Union by 2007. Likewise, they nudged the Romanian government to pursue unrelentingly required reforms with regard to industrial restructuring, public administration and the judiciary system.

This analysis aims at presenting a succinct overview of economic developments in Romania and likely immediate prospects at the end of the first half of 2003. In order to make this brief assessment it pays to consider some premises which are rooted in the economy's dynamics.

Macroeconomic Premises

Economic recovery has continued after years of massive decline of overall production and a drastic balance of payments adjustment in the late 90s. The rise in the GDP has been quite rapid in the last couple of years, which matches an evolution one encounters in other accession countries as well. The increase of the GDP in the first quarter of 2003 was estimated by the National Institute of Statistics at 4.4%, albeit a question mark arises in this respect in view of the slowed down pace of industrial production and services during that quarter (these sectors have grown by 2.5 and, respectively, 3.6% in the same period).

Disinflation has been well underway (Fig. 1) and the economy is moving toward the single digit frontier, which would mark a major achievement as against the past decade. Arguably, the USD depreciation (vis-à-vis Euro) in 2002 played a significant role in mitigating inflationary expectations and a quasi-exchange rate based stabilization program operated last year

Romania has been running relatively small current account deficits in recent years – below 4% in 2002 (Fig. 2); these deficits have bolstered the country's credentials to get improve ratings and access more cheaply foreign capital markets. As a matter of fact, Romania received better ratings from the main agencies in 2002 (BB-), but is still several notches below an investment grade. Budget deficits of around 3% were registered in the last few years, which meet the benchmark set by the Maastricht criteria for EU accession; in 2002 the budget deficit was -2.67%. The economy has a low external indebtedness, of

cca 30% of GDP (Fig. 3) and a small part of it is short-term; this fact helps to access foreign capital markets.

There has been a large expansion of trade in recent years, but low value added products continue to hold a major share. Likewise, domestic credit has grown quite rapidly in the same period of time, which supported the growth of the non-governmental sector, of the economy in general. Capital account liberalization is programmed to be completed, in the main, by 2004. Two restrictions are, however, put in place; one regards transactions in the Romanian money markets by non-residents and purchases of land by non residents.

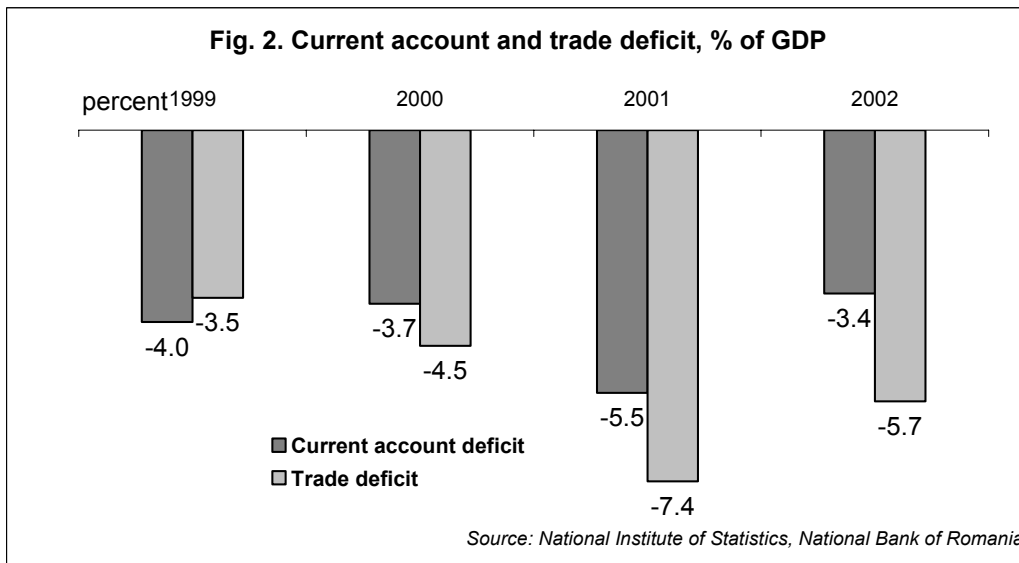
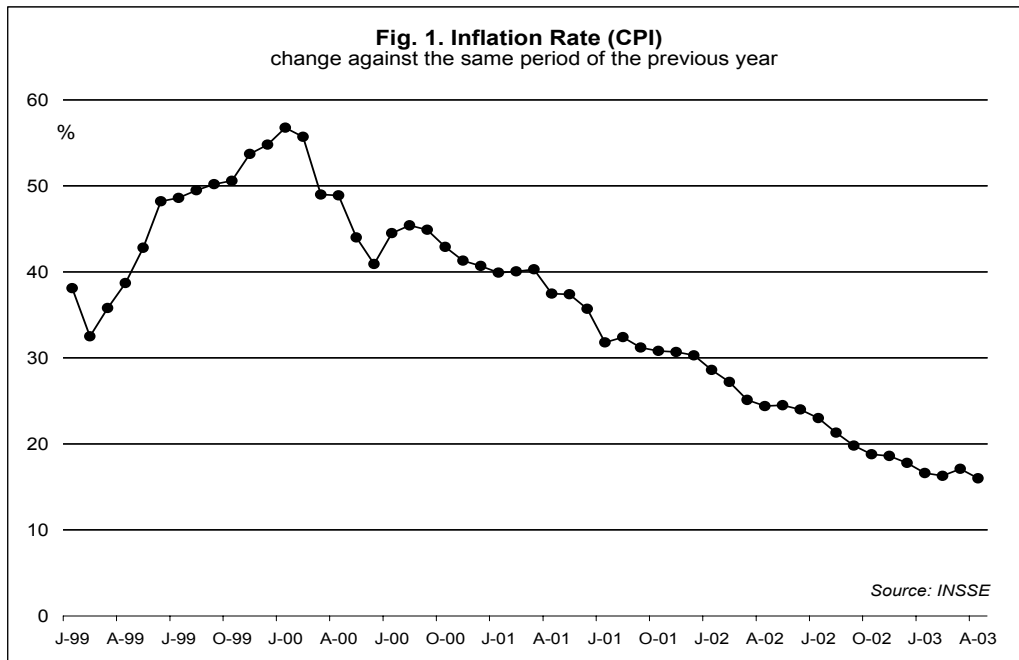


Fig. 3. Macroeconomic indicators

	2000	2001	2002	2003*	2004*
Real GDP, % change	2.1	5.7	4.9	4.5(?)	4.5(?)
Inflation (CPI)	40.7	30.3	17.8	13(?)	10(?)
Budget deficit	-3.5	-3.3	-2.7	-2.7	-3.5
Current account deficit	-5.7	-5.6	-3.6	-4.5(?)	-5
Official reserves (bn USD)		4.8	7.1	7(?)	
Total ext. debt... % GDP,		31	35	32	34
% of exports		81	85	85	
Interest payments, % of exports		4.1	3.8		

Source: National statistics and own estimates; *forecast

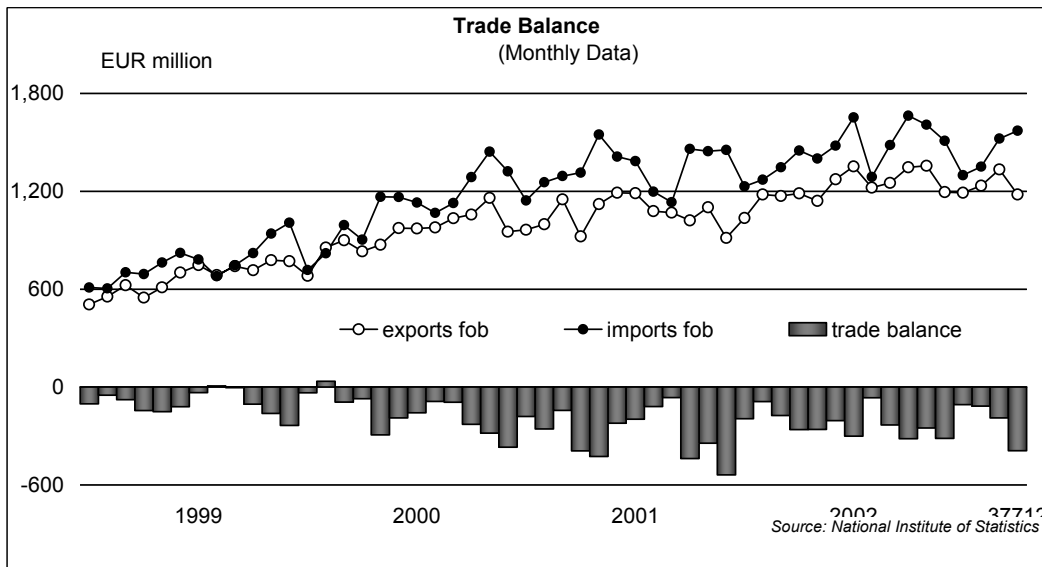
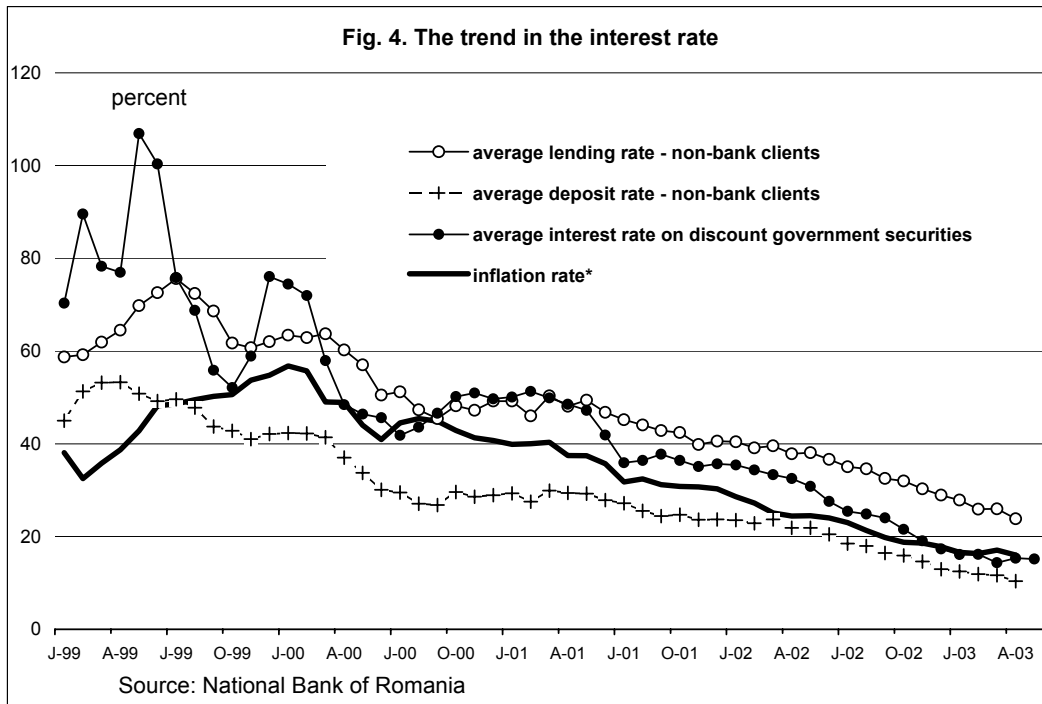
The macroeconomic premises underlined above need to be judged against the background of a series of structural features of the Romanian economy which condition its future dynamics:

- whereas the private sector accounts for more than 66% of GDP, financial indiscipline continues to be quite high –arrears afflict the energy sector in particular (the losses in this sector amounted to cca 2% of GDP in 2002, according to some estimates);
- there is an ongoing crisis of social security, which is due primarily to the stark imbalance between active and retired population and its aging;
- while the banking sector is much cleaner currently (as evidenced by the small share of non-performing loans) than in the late 90s, there is heavy dolarization of the economy (60% of deposits are hard currency denominated)
- monetization is low (M2 is only 25% of GDP), which exposes the economy to the impact of large swings of capital flows and implies high costs of sterilization for the Central Bank; the low monetization reveals some pitfalls of a too fast liberalization of the capital account;
- the low current account deficits of recent years have been enhanced by rising remittances from abroad (over 1.5 billion USD in 2002) –Romania has become a significant exporter of both skilled and unskilled labor.

Macroeconomic Policies in 2002 and 2003

In order to continue disinflation simultaneously with economic growth macroeconomic policy has relied on a special complexion of its mix. The main traits of this policy mix have been: (a) keeping the budget deficits low and relaxing the tight monetary policy, so that the latter supports economic recovery (Fig. 4); (b) a real exchange rate

appreciation as against a currency basket, in order to help disinflation; and (c) declining lending interest rates in ROL (the domestic currency) in order to enhance domestic credit, at a time when hard currency denominated credit grew, arguably in excess.



There are several domestic and international developments which have provided the context of implementation and conditioned the efficacy of the policy mentioned above:

- a sharp appreciation of the Euro vs. the USD which has complicated the exchange rate policy and, probably, imparted

an inflationary bias to this (the still high inflation rate in Romania and an exchange rate appreciation policy as against a currency basket makes it such that, when the Euro appreciates too sharply against the USD the implied ROL's depreciation against the single currency creates some inflationary pressure);

- the ongoing recession in the European Union, which cuts from the stimulus to Romanian exports (which have been driving economic recovery in 2001 and 2002);
- the great uncertainty in the world economy and the high risk aversion of investors, which makes them highly discriminatory among emerging markets; consequently, there has been more reliance on domestic demand for growth in 2003 (than in 2002);
- a growing current account deficit in 2003, which is not surprising in view of the economic recovery and bigger imports related to domestic investment;
- considerable arrears in a period of disinflation, which perpetuate substantial quasi-fiscal deficits and may imperil future public budgets;
- a nervous domestic foreign exchange market due to capital outflows, and, probably, less capital inflows (errors and omissions turned negative in 2002, to -776 million USD, and reached 654 million USD in the first quarter of 2003)

The goals of macroeconomic policy in conjunction with the developments highlighted above create a set of policy challenges for the second half of this year and 2004.

Challenges and Risks for Macroeconomic Policy in 2003

What can slow down economic growth?

The rise in the GDP was estimated at about 4.4% in the first quarter of this year by the Institute of national Statistics. More than this number in itself (which includes household and underground output, with these components evincing the most rapid expansion) the figures concerning industrial production and services – which, together, account for over 75% of GDP, give some pause for thought. If the dynamic of these sectors does not speed up, on average, in the other three quarters the official GDP target for 2003 would be hard to attain. In addition, the very likely poor agricultural output would make this outcome more probable. The bottom line is: the dynamic of the GDP needs to be examined in the context of the overall macroeconomic performance; what matters for Romania, essentially, is to have sustainable growth together with disinflation and easily financed current account deficits.

What can cause an inflationary slippage?

A possible cause of an inflationary slippage could be a continuing sharp appreciation of the euro (against the USD) in keeping with the exchange rate policy practiced by the NBR in the last couple of years. Some argue that this appreciation is not threatening since the USD would, still, shape inflationary expectations in Romania and a large portion of imports is dollar denominated. I find this argument insufficiently convincing for several reasons: already, many transactions and prices are related to the euro once the single currency became, officially, the reference currency on last March 1st; moreover, basic excises (especially for gasoline) are calculated in the euro, whose nominal and real appreciation vis-à-vis the ROL has been quite high in the first five months of this year. In the first five months of this year the ROL depreciated vs. the Euro by cca 8% in nominal terms and by more than 2% in real terms. At the same time the ROL appreciated both nominally and really vs. The USD. This is why it makes sense to think about how a possible negative influence can be counteracted?

There are two basic scenarios in this respect. One scenario bets on a USD recovery, which would provide an enormous bonus to disinflation in Romania by reproducing the circumstances of last year. In addition, a decline of the euro would relieve the pressure of the rise in various excises. But this scenario, although with a reasonable likelihood to occur in view of the growth differentials between the USA and the Euroland, is not a policy contingency plan per se.

The other scenario regards a further appreciation of the euro during 2003, however implausible it may seem to some. But policy making has to consider such a situation. Should it happen and should the Central Bank not resort to an excessive appreciation of the ROL (as a means to combat the inflationary pressure), a tighter monetary policy may have to be implemented. But a tightening of monetary policy would raise, or slow the decline of the cost of borrowing, which would impact growth negatively. On the other hand, higher interest rates would relieve the strain in the forex market (a negative effect would be, however, a further stimulus to demand for hard currency denominated borrowing). Consequently, the National bank of Romania would have to calibrate very cautiously its instruments so that it balances the simultaneous goals of sustained growth and disinflation; a good calibration would avert a too visible trade-off.

How appropriate is the level of interest rates?

The second half of 2002 and the first five months of this year have witnessed a rapid decline of interest rates. Aside from the need to bolster economic growth the decline of lending rates for ROL-denominated credits was seen as a tool to mitigate the risks of excessive hard currency denominated borrowing. But passive interest rates declined, arguably, too rapidly and this has showed up in a drop of ROL denominated deposits in the second quarter of this year (which

may reflect. Moreover, the fall in domestic interest rates may have increased the propensity of some capital to flow out of the country, against the backdrop of capital account liberalization. The lesson is: there is need for caution with the speed of lowering interest rates so that bank deposits (in ROL) be not harmed and the balance of payments not strained exceedingly.

Has the expansion of hard currency denominated domestic credit been too rapid?

While the expansion of domestic credit (by more than 25% in real terms in 2002) was widely hailed early on some alarm was expressed by NBR officials lately with regard to the rapid increase of hard currency denominated lending. The concerns revolve around exchange rate risk in view of the wild gyrations on currency markets and the lack of routine of Romanian companies to use hedging for forex risk protection. Some commercial bankers have contended that the NBR's stance in this regard is overcautious since –they assert – most lending is done out of deposits made by residents. However, they seem to overlook that the distinction between domestic credit based on foreign borrowing vs. that based on deposits made by residents is fundamentally dented when the capital account is liberalized – which is the case with current program of KAL in Romania.

Is the rise in imports worrying?

The first five months of 2003 showed a significant rise in imports, which have grown to over 8.7 billion USD, while the trade deficit went beyond 2 billion USD. If this trend continues the current account deficit may approach 5% this year. This level of the deficit should not be of concern were the biggest portion of additional imports made up of capital goods and their financing were done easily. What surprises, however, is that imports have increased so much while the pace of growth of industrial output and services (which make up most of the GDP) was not impressive in the first quarter of this year. It may be that this pace accelerated in the second quarter.

Do arrears pose an increasing threat?

Financial indiscipline continues to plague the Romanian economy and it shows up in substantial arrears. For instance, the losses in the energy sector amounted to about 2% of GDP in 2002 (according to some estimates). Arrears do create quasi-fiscal deficits, which may imperil future public budgets unless addressed in due time. Data for this year are quite scarce, so that an adequate judgment is hard to make in this regard. It is clear, nonetheless, that disinflation strains the balance sheet of inefficient companies, for the latter (and not only) used inflation as a weapon to cut their liabilities in real terms. The evolution of arrears needs to be watched carefully by policy-makers.

Risks in 2004

There is a series of areas of possible concern in 2004, which demand policy makers' attention. Prominent among these is the danger of excessive populist macroeconomics in an election year. Populism may take also the form of imprudent wage policy (unjustified pay rises in the public sector); dangerously declining interest rates, which may fuel again inflation; leniency towards tax offenders, which may worsen financial indiscipline, etc.

The Ministry of Finance has aired the idea of a larger budget deficit in 2004 (of cca. 3.5%), in order to finance additional infrastructure projects. Can Romania afford a higher budget deficit? The IMF would likely oppose such a move in view of the disinflation effort and the need to reduce crowding in the economy. The Maastricht criteria would also point against such a rise. However, there may be leeway for the Government to increase the budget deficit assuming that: financial discipline improves in the economy and quasi-fiscal deficits go down; most of the rise in the budget deficit is financed externally and, thereby, crowding out is limited; and last, but not least, the rise in the budget deficit is used exclusively for the purpose of infrastructure work. All this said, the Government would have to realize that increasing the budget deficit, unless it is accompanied by a remarkably disciplined policy making, poses significant risks –especially in an election year. And major slippage, of any sort, would undermine credibility, in a critical period for improving Romania's credentials to join the EU and bring her rating nearer to an investment grade.

Another area of concern is the fragility of the non-bank financial sector, which asks for resolute action and a strengthening of supervision activity. Should capital outflows go on at an excessive pace a reassessment of the current program of capital account liberalization would be needed.

As a matter of principle, policy makers should have at the very top of their agenda Romania's not losing contact with other EU accession countries in terms of economic performance. 2004 is the year of EU entry for seven Central European countries and Romania needs to do much better economically so that 2007 become a realistic admission date.

3. SOCIETY

A demographic time bomb?

TRENDS

The National Institute of Statistics started to release the final results of the 2002 population census. According to these data, Romania has lost over 1 million inhabitants, or 4.2% of the population, since the previous census, in 1992. Moreover, extrapolating these trends, the Institute forecasts that by 2020 the Romanian population will decrease by a further 1.8 million. The data has unleashed a wave of public *angst* and self-doubt over the fate of the country. The question this paper poses is how worrisome the data really are, and what if anything could be done about them. Demographic trends are hardly susceptible to government intervention, as they reflect deep social and cultural transformations. We believe therefore that it is advisable to shift government policy so as to take into account these trends, especially by introducing incentives in the social insurance system to encourage people to contribute for longer and to rely less on public social security mechanisms. The forthcoming EU integration will make the challenges more acute, as it will open the perspective of increased mobility of younger and better educated people, and will force us to eventually address the underdevelopment of rural areas.

CONCERNS

Beyond the uncomfortable feeling of being a sort of endangered species, the Romanian public's concern over the decline of the population is related mainly to the ageing of population, and to its consequences over the sustainability of the social insurance system (the pension system first of all). In addition, many analysts perceive the high, and growing share of rural population as a drain on the economic development and a vulnerable spot in the EU enlargement process. Not least, the life expectancy, and mortality statistics show Romanians trailing behind our CEE neighbors, let alone the EU partners.

Population decline

The drastic population decline has two sources. On one hand, there is the migration out-flow. It peaked early in the last decade, after the 1989 regime change, and has stabilized at a low level lately. The largest population fall however comes from the negative natural

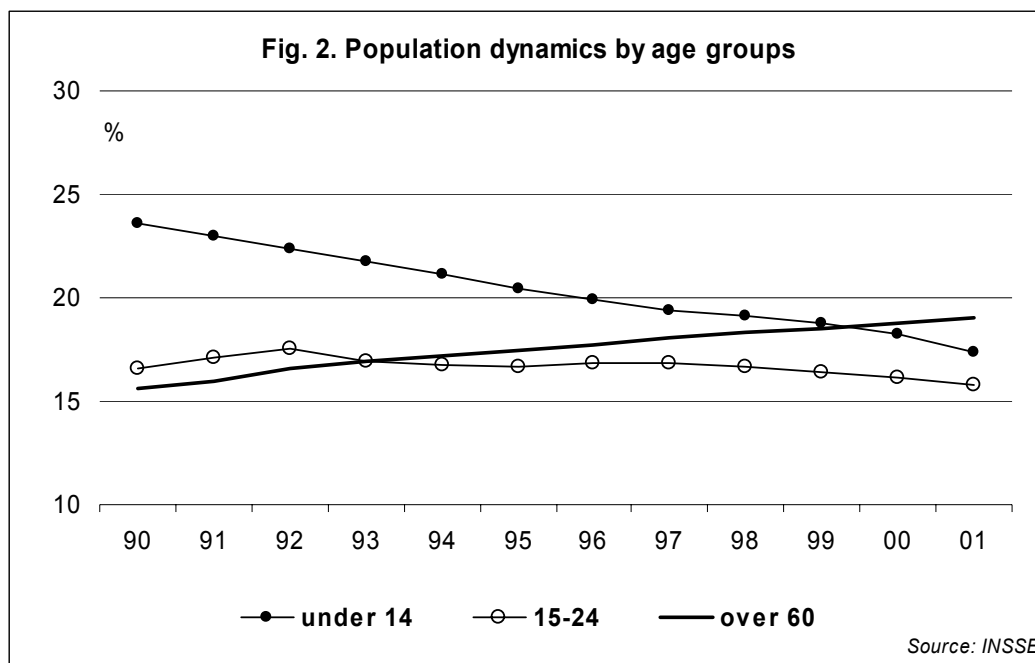
growth. The birth and fertility rates have dived after 1989. In contrast, (male) mortality rate has surged, possibly in connection with the stress of transition. Life expectancy at birth declined over the 1990s, but the bottom has been reached in 1996, and it has bounced back a little since. The differential between gender life expectancies remained wide, suggesting that men have been more affected than women.

Some key indicators are presented in Fig. 1. Romanian population is now back at the 1980 level. The population has peaked in 1990, and has started to drop due to the strong emigration. The natural growth has stayed positive till 1991, but has turned negative afterwards. As the flow of emigration has stalled in the second half of the 1990s, negative natural growth has replaced it as the main cause of the population drop. Natural growth has also two components – birth rate, and mortality rate. The birth rate has steadily decreased since 1989. The death rate has increased after 1989 (mostly due to a substantial drop in male life expectancy), but reached the bottom in 1995 and bounced back afterwards.

Fig. 1. Population dynamics

	1981	1985	1989	1990	1991	1992	1994	1996	1998	2000	2001
Total population (Mil)	22.35	22.72	23.51	23.20	23.18	22.79	22.73	22.61	22.50	22.43	22.39
Birth rate (per '000)	17.0	15.9	15.8	13.6	11.9	11.5	10.9	10.2	10.5	10.5	9.8
Mortality rate (per '000)	10.0	10.9	10.6	10.7	10.9	11.7	11.7	12.7	12.0	11.4	11.6
Life expectancy at birth – average	69.60	69.70	69.76	69.78	69.52	69.48	69.05	69.24	69.4	70.6	71.3
Male	66.83	66.81	66.59	66.56	66.06	65.88	65.30	65.46	65.5	67	67.7
Female	72.40	72.65	73.05	73.17	73.17	73.32	73.09	73.32	73.3	74.2	74.8

Source: INSSE



Ageing

Data also support the claim that Romanian population is ageing. The share of population over 60 years old has surpassed the proportion of those below 15 in 2000 – the latter have dropped in a decade from almost a quarter of the population, to less than 18% (Fig. 2). The smaller cohorts born after 1989 enter fertility age. Coupled with continue low birth rate, and improving life expectancy, this might result in the ageing of the population gathering speed.

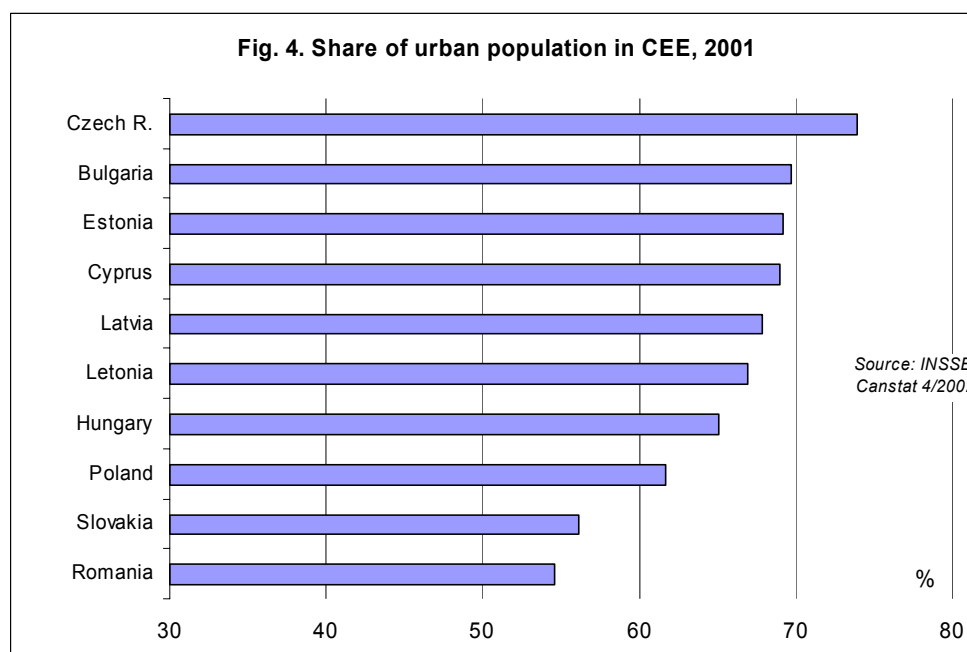
Rural population

The share of the population leaving in the rural areas has marked a surprising increase (Fig. 3). Romania has the largest share of rural population among CEE countries, way over the EU average of less than 20%. Fig. 4 presents these comparative data for 2001 – Romania has the lowest urban population, thus corresponding to the highest urban one. These comparative statistic have however to be read with a grain of salt, because the definition of urban and rural municipalities varies from a country to another. In Romania, there is tendency to promote the 'town' status small, former rural municipalities, those artificially enhancing the urban share of the population.

Fig. 3. Urban/rural dynamic between censuses

	2002		1992		1992-2002, % change
		%		%	
TOTAL	21,698,181	100.0	22,810,035	100.0	95.8
URBAN	11,436,736	52.7	12,391,819	54.3	92.3
RURAL	10,261,445	47.3	10,418,216	45.7	98.5

Source: INSSE



A few months after the population census, the Romanian Institute of Statistics has also conducted an agricultural census, which will be used in determining the CAP (Common Agricultural Policy) support to Romania after accession to EU. The agricultural census, using a different methodology, found that only 28.3% of the active population is actually employed in agriculture. Still daunting, the later is a much smaller figure. The Prime Minister was unhappy with the conduct of the agricultural census, and publicly rebuked the president of the National Statistic Institute, who consequently resigned. The controversy over this sharp revision of official statistics is thus likely to continue.

Habitation

There are also pieces of good news in the data. This is the case with the habitation situation, where the reduction in population, coupled with increased built area has resulted in a marked upswing in the leaving area per person (see Fig. 5). Moreover, the increased number of households, and the lower number of people leaving in a household suggests younger people have been able to leave parental homes earlier than previous generations.

Fig. 5. Improving habitation conditions

	2002	1992	2002 in % against 1992
Number of households	7,392,131	7,288,676	101.4
Mean number of persons per household	2.89	3.07	94.1
Number of buildings	4,846,572	4,491,565	107.9
Number of dwellings	8,110,407	7,659,003	105.9
Number of habitation rooms	20,702,994	18,847,496	109.8
Surface of habitation area – '000, sqm	304,253	258,518	117.7
Mean habitation area per dwelling – sqm	37.5	33.8	110.9
Habitation area per person – sqm	14.2	11.5	123.5

Source: INSSSE

Fig. 6. Breakdown by population age groups in EU candidate countries

% of population age groups out of total, 2001	Bg	Cy	Cz	Est	Hu	Lv	Lit	Pol	Ro	Slov	Sk
Total	100	100	100	100	100	100	100	100	100	100	100
-14	14.6	21.5	15.9	17.2	16.3	16.6	19.0	18.2	17.4	15.4	18.6
15-24	13.9	15.5	14.6	14.9	14.1	14.8	14.6	16.9	15.8	14.2	16.8
25- 59	49.0	46.9	50.9	46.3	49.0	46.7	46.9	48.1	47.8	50.7	48.9
60+	22.5	16.1	18.6	21.6	20.6	21.9	19.5	16.8	19.0	19.7	15.7

Source: INSSSE

Data Assessment

The demographic trends are worrying, but they have to be put into perspective. If we compare other CEE countries, Romanian population is neither older, nor registering a larger decline. Neither is our demographic dependency rate worse than that of our neighbors. For exemplification see Fig. 6 below. Both in what concerns the share of the younger than 14, and of the over 60 year old Romania is not an outlier.

The population decline *per se* is not necessarily a disaster. The view of a growing population as a source of national strength is rather unfashionable today. Its connection to national prosperity (in per capita terms) is not straightforward. What is really troubling in Romania is the very high dependency rate measured as the number of beneficiaries of social security per number of contributors. From the over 10 million active population, only 4 million Romanians are legally employed, and therefore pay for social insurance. Fig. 7 shows the evolution of this crucial indicator after 1990. Starting with a healthy situation where employees outnumbered the pensioners more than three times, by 2000 the two groups were even, and the downward trend continued ever since. Two factors were in play here. On one hand, the number of employees declined, as the unemployment surged, and especially as many people took refuge in the black economy, or used part time contracts (*convenții civile*) to bypass paying full social contributions. Equally important however was the huge rise in early retirement (many times an alternative to unemployment), and retirement for medical reasons (many times fraudulent). This situation has little to do with demographic dynamics, and more with the general economic climate, incentive structure, and law enforcement.

The population decline *per se* is not necessarily a disaster

The population decline is based mainly on the lower fertility rate. This is the trend however least likely to alter, as it reflects deeper social changes. Many analysts have connected the decline in fertility with the economic and social trials of transition. An improvement in the economic outlook will probably increase the willingness of people to raise children. But similar decreases in the fertility rate have been registered in CEE countries which have recovered better from transition, and also in the affluent Western European societies. Figure 8 shows that, among CEE countries, Romania actually has the highest birth rate.

The statistical data also show that people postpone (the first) marriage, and have children later. 2000, with 135,800 marriages, had the lowest crude marriage rate (6.1 per '000) of the postwar period. Life style factors are probably an equally important factor in these choices as is the economic situation. Evidence for this is the finding that only 5% of children are born by women who graduated higher or secondary education. Taking into account that Romanians record the widely met correlation between education attainment and income, this data suggests there is a negative correlation between income and the number of children.

After 2005, the active population (both economically and from the fertility point of view) will start to include the lower cohorts of post-1989. Combined with the low fertility, this lower intake will result in both fewer births, and a higher demographic dependency rate (i.e. dependents per active population). Where an improved economy will clearly be beneficial, is in its impact on life expectancy. Romania trails badly in this respect, both compared to EU countries, and even to its CEE neighbors (see Fig. 9). The 1990s have been extremely tough on Romanian males, who registered a decline in life expectancy. The trend is now positive. A stable and improving economic situation will allow life expectancy (both due to psychological factors, and to increased spending on healthcare) to start gaining ground. Welcome as this development will be, it will contribute to the ageing of the population, thus worsening further the demographic dependency rate.

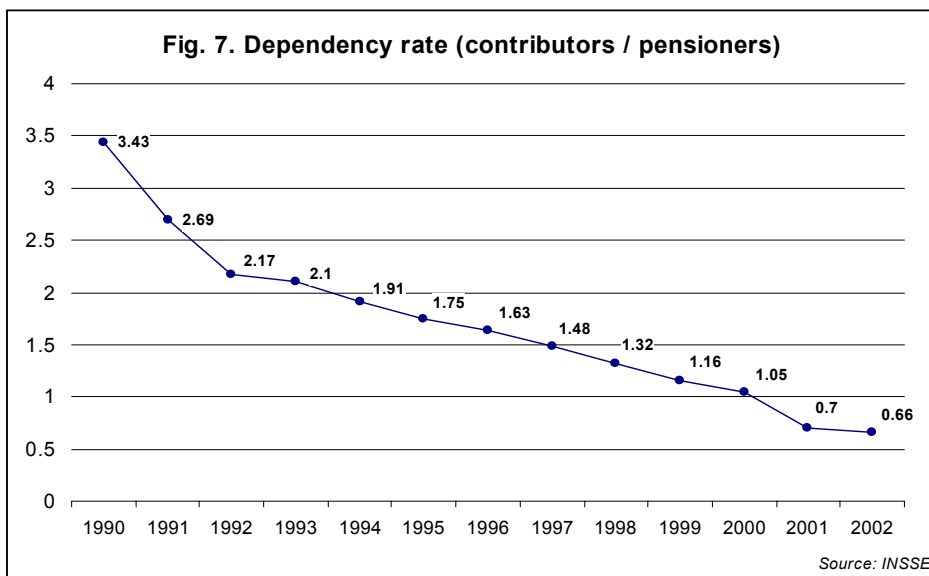


Fig. 8. Live births and natural increase across CEE – 2001 data

	Bg	Cy	Cz	Est	Hu	Lv	Lit	Pol	Ro	Slov	Sk
Live births on 1000 habitants	8.5	11.6	8.9	9.3	9.5	8.3	9.1	9.5	9.8	8.8	9.5
Natural increase on 1000 habitants	-5.8	4.8	-1.7	-4.3	-3.4	-5.7	-2.5	0.1	-1.8	-0.5	-0.2

Source: INSSE

Fig. 9. Life expectancy across CEE – 2001 data

	Bg	Cy	Cz	Est	Hu	Lv	Lit	Pol	Ro	Slov	Sk	
Life expectancy (on birth – years)	M	68.6	76.1	72.14	64.73	68.15	65.2	65.9	70.2	67.69	72.1	69.54
	F	75.3	81.0	78.45	76.22	76.46	76.6	77.4	78.4	74.84	79.6	77.60
Life expectancy (at the age of 65 - years)	M	13.0	16.5	14.00	12.6	13.04	12.5	13.3	13.9	13.38	14.2	13.53
	F	15.6	19.1	17.13	17.2	16.74	17.8	17.7	17.7	16.00	18.2	17.14

Source: INSSE

WHAT CAN WE DO ABOUT IT***Improve the dependency rate***

Worrying as the deteriorating demographic dependency rate might be over the longer term, the current problems of the social security system – primarily pensions – come from the low number of contributors. The official retiring age is supposed to raise over the next 13 to 15 years from 62 for men, and 57 for women, to 65 for all. We have however to bear in mind that Romanian pensioners are relatively young, many of them retiring before the official age, either on medical grounds, or under different early retirement schemes. These practices have to be curbed, and the alleged corruption associated with many medical retirement / disability benefits decisions stamped out for the effects of the law to really bear fruits.

The real problem (high dependency ratio) is due to poor government policies, not demographic trends

The key element, however, is the incentives people face. Good government policies should to determine them to work (and contribute) longer, cater more for their own needs, and rely less on public schemes vulnerable to free riding and political risk. Generally, this can be achieved by linking closer the level of benefits to the contributions paid in the system. In the case of pensions, a system based on capitalization would provide the right incentives. The government is unfortunately moving slowly to enact a questionable volunteer supplementary occupational private pension, risky because of its dependence on the fate of the employer company, and under undue trade union influence. The more sustainable World Bank supported compulsory funded scheme looks to have been abandoned. Similarly, in the case of healthcare, supplementary private insurance, or even (tax free) health saving accounts might do the trick. Providing tax incentives for pensioners who continue to work post retirement (e.g. part time) might also encourage some of the 'young' Romanian retirees to return to employment.

Improve the fertility rate

As mentioned earlier in the article, we remain skeptical that the choice of families to have children could easily be influenced by public policy – at least in a democracy. An improved economic climate will go some way towards achieving this objective. The government intends to gradually increase the amount of child benefit, to up to 10% of the net average wage. This is welcome from the perspective of fighting poverty. In Romania, the number of children is the best predictor of a family leaving in poverty. An increase in the value of the child benefit will go a long way towards improving the fate of children from poor families. Encouraging poor people to have more children is however a questionable policy. Educational attainment of children is correlated with that of parents. The proper policy objective is to determine better educated, better earning people to establish a family. As we have discussed above, it is exactly this type of people who postpone having children. It is unlikely that the flat rate child benefit would have any impact on the decisions made by this category. Conversely, higher earning mothers will be negatively affected by the introduction next year of the (low) flat rate maternal benefit. Moreover, the reforms of

the education system have gradually eliminated in the last years the extra-curricular services provided in the few number of schools where they had survived the early years of transition (such as catered meals or partial after-class boarding). It is precisely such services which were extremely helpful for working mothers, who many times lack time more than they lack money to contribute to their financing. *On balance, the government policy does not seem sensible or very coherent, as it overall discourages higher earning women from becoming mothers, strengthening an already manifest natural (negative) trend.*

Another questionable government policy is the planned introduction of supplementary benefits for single mothers. It is obvious that women who raise their children alone are in a more vulnerable situation, both in terms of their own welfare, and that of the children. There are however serious reasons to question this approach. On one hand, the demographic statistics have shown that, as people postpone or refrain from marriage, up to a third of couples will not choose to legalize their relationship. Therefore, using as proxy the status of a woman might fail to identify the actual single mothers. On the other hand, tying a benefit to the unmarried status of the woman might have the self-defeating consequence of encouraging the recipients to refrain from marrying, and thus preserving their vulnerability.

Emigration

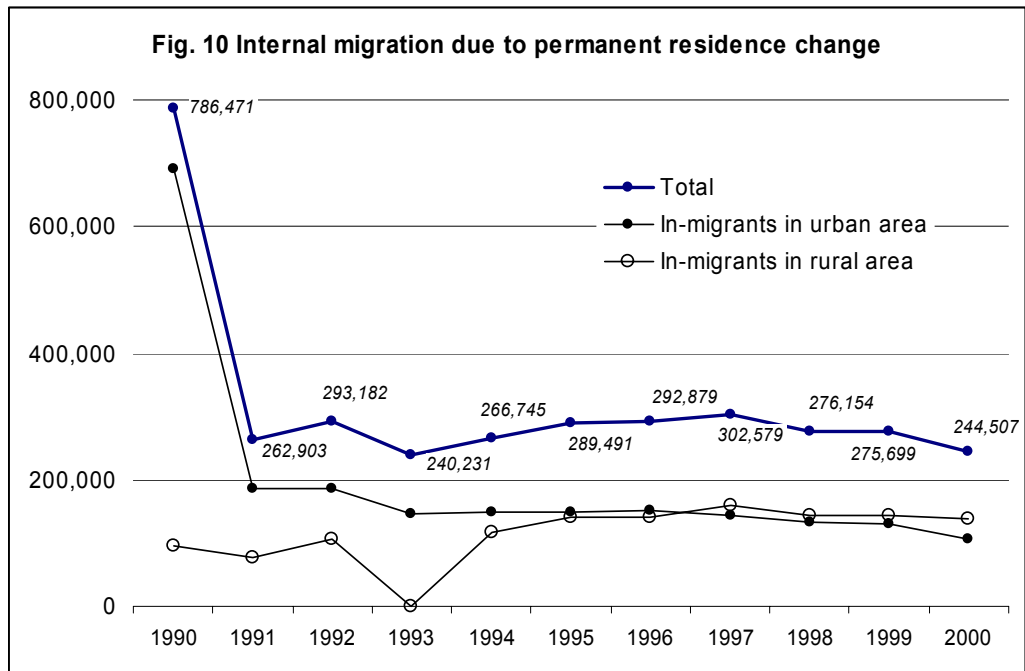
Statistics show that the emigration flow has thinned lately. The lifting of visa requirements for EU did not result in a huge flux, and most of those who leave engage in circulatory, seasonal migration. These are however the legal emigrants. Illegal migration can not be measured exactly, but it is estimated to be large.

This apparent calm might be challenged by the accession to the European Union. It will, especially after the full liberalization of the free movement of laborers, drastically improve the mobility of Romanian workers. Those most likely to benefit will again be the younger, and better educated, who possess the necessary language skills. Their emigration will pose many problems for the Romanian society. In spite of the public discourse on the need to create a better environment for the (re)integration of the most intellectually gifted Romanian youths, many of whom return home from scholarships abroad to face an unknown future, little has been achieved so far. The integration in EU will raise the challenge for the Romanian society to find the incentives to keep home its more gifted and mobile members.

People need to face the right incentives – to stay in (or return to) Romania, and work longer

Cope with an over bloated rural sector

The gravest challenge for the European integration of Romania is however the huge proportion of the rural population. The reversed migration from town to village has been a strategy to cope with the dislocations produced by the transition, by taking refuge in the cheaper (and only partly money based), slow path rural economy, dominated by 'survival agriculture'. It is extremely worrying that this phenomenon has gathered pace after 1997, when for the first time the overall trend of internal migration was away from cities, and into rural areas (see Fig. 10).



Poverty is endemic in the rural areas. The Romanian village trails the town on practically any human development indicator. The improvement of the economic environment will also help to reverse the flow of internal migration, back from village to town. The share of the rural population will however remain considerable for many years to come. Rural development is going to be a challenge for the Romanian government. The pressure will grow once the country is integrated in the European Union. The rather backward Romanian agriculture will have difficulties when fully exposed to the European competition. On the other hand, the very large number of Romanian farmers will represent a growing burden on the intervention mechanisms of the Common Agricultural Policy, which seem to move away from subsidizing agricultural output, and towards income support for individual farmers.

Conclusions and Recommendations

- *The results of the census have been a shock to the public opinion. The drop in the number of population was larger than expected. Behind the light catching numbers, there are more real and serious challenges. An improved economy will positively affect all of them, but special policy interventions will be needed also. Demographic trends have deep seated causes, and they are not very susceptible to the intervention tools open to a democratic government, which will have only a marginal success at best.*
- *The drop in population numbers is not an evil in itself, and theoretically could even have beneficial consequences. Romanian population is still relatively young when compared with both EU countries, and our CEE neighbors. The severe Romanian problem of the economic dependency ratio has been induced more by policy, than by demographics. The government should encourage*

people to retire later, and to rely more on their savings (under different forms) to cater for their needs. Unfortunately the creation of the private pension system is not on government agenda. Its preferred option of occupational pensions presents considerable risks, and since it is strictly volunteer will have a much reduced appeal. In the health field, supplementary health insurance (which is under consideration), and health saving accounts could offer a way forward

- The decline in the fertility rates is a general European phenomenon, and is likely to stay with us. The government is devising a number of policy initiatives (increased child benefits, and special benefits for single mothers) which are supposed to alleviate the problem. These policies are however better suited for poverty alleviation (and even that is questionable for the second one). The real problem is that more affluent people refrain from having children, and for them the government policy is more a deterrent (i.e. the introduction of the flat rate maternal benefit, instead of the earnings related one).
- Emigration appears to be kept in check. The forthcoming accession to EU will however open the opportunity to emigrate to many of the younger and better educated people the country can ill-afford to lose. The government needs to devise a policy devised to this more mobile minority.
- The continuous ruralization of Romania is the consequence of a deeply non-functional economy / society. The EU integration will force us to face this challenge sooner rather than later. While an improving economic climate may stop and the trend may even reverse, the problem posed by the huge underdeveloped rural population will be with us for many years to come. The development of rural Romania is one of the most serious challenges for any Romanian government, and despite funds to address it flowing from various organizations, no comprehensive strategy was yet produced. The government should create a pool of interested parties, business organizations and think-tanks to work jointly on producing such a strategy, submit it to the public debate and use it as the main basis on negotiating Agriculture and Regional Development with the European Union.

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