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ROMANIAN PENSION REFORM IN COMPARATIVE PERSPECTIVE

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PART II

**Social and Economic Conditions of Romania for Pension Reform
in Comparison with Other European Transition Countries**

(by Akira UEGAKI)

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Demographic tendency

Romania's population is the second largest in the Central and Eastern Europe with about 22.3million people. However, the demographic tendency of Romania has not been straight forward and traced zigzag course influenced by several factors specific to Romania. The characteristics of the demographic trend of Romania since 1990 are the followings.

- (a) After 1990 the fertility rate of a Romanian woman has been decreasing to an extremely low rate reaching 1.3 in 1998. It is a result of people's reaction to the pro-birth policy of the previous regime in the last 30 years which was initiated by Ceausescu in 1966.¹
- (b) On the contrary, the death rate per 1000 habitants has been kept at the previous level and even increased in some years. Therefore the natural increasing rate of population of Romania has been negative since 1992 until now.
- (c) Therefore it is true that ageing of the Romanian population is proceeding fast as in the other transition countries, but it will advance with some special features to Romania. People over 65 will increase and people at working ages of 16-64 will decrease both at a considerable rate from 2029 and 2015 onward respectively.
- (d) Apart from natural flow of the population, there was a strong social tendency of outflow migration from Romania. From 1990 through 2000 total net migrants (immigrants minus emigrants) were -239.4 thousand. This population decrease was more than natural population decrease in the same period (Vasile, 2002, p.41). However, it must be noted that the surge of emigrants has calmed down in recent years and that repatriation of Romanians are also observed (Vasile, 2002, p.12).

Table 1 shows the "old-age dependency rate" of four transition countries. Here the "old-age dependency rate" means a number of the people over 60 (in stead of 65) divided by

¹ See the last part of this section.

a number of the people at ages of 20 – 59 (instead of 15 – 64). In Table 1 Romania represents a peculiar status in the transition countries in a sense that the figure increased from 29.7 to 33.6 whereas the figures of other countries were stable. Figure 1 shows the longer trend of Romanian population. Table 1 and Figure 1 suggest that ageing of Romanian population started before the transformation of the regime and is approaching to the level of the Czech Republic recently.

Table 1) Old-age Dependency Rate¹ of Selected Transition Countries

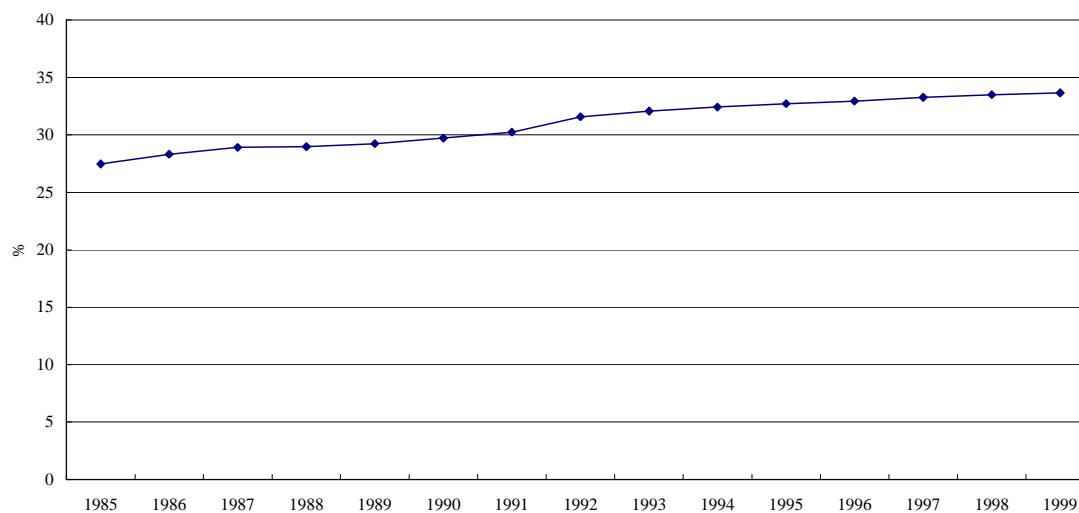
	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Hungary	35.0	35.5	35.8	36.0	36.1	36.1	35.9	35.6			
Poland	28.0	28.6	29.0	29.0	29.5	29.6	29.8	29.9			
Czech Republic	33.5	33.8	33.8	33.7	33.4	33.0	32.5	32.0			
Romania	29.2	29.7	30.2	31.6	32.1	32.4	32.7	32.9	33.3	33.5	33.6

Note) ¹ = 60+ years old in % of 20-59 years old.

Source) Hungary, Poland, the Czech Republic: Schrooten, Smaeding and Wagner, 1999, p.28.

Romania: Calculated by the author using the data of ASR, 2000, Table 2.1.3.

Figure 1) Old-age dependency rate¹ of Romania



Note) ¹ = 60+/20-59
Source) ASR, various years

These data, however, do not reflect the total effect of the above mentioned tendencies, because the most of the effect will be realized in the future. For the future trend, we can use the United Nations' World Population Prospect (version 1998). Table 2 indicates the future old-age dependency rate (here it means the population over 65 divided by the

population at the ages 16-64) of Romania and other transition countries using the United Nations' Prospect. According to this table, Romania will experience population ageing gradually from 2010 and the speed of ageing will be accelerated during 2030-2050. This corresponds to the above mentioned forecast about the population of old and working generations. As for other countries, it is worth noting that Hungary, Latvia and Poland will not have so severe ageing problem as Romania at the middle of 21st century. On the contrary, the Czech Republic will have serious ageing problem from 2030 to 2050.

Table 2) Future Old-age Dependency Rate¹ of Selected Transition Countries and Europe²

	2000	2010	2030	2050
Europe	21.7	23.6	36.6	47.5
Eastern Europe	18.8	19.4	31.0	44.1
Albania	9.5	11.4	20.2	29.8
Bulgaria	23.4	24.1	33.7	52.0
Czech Republic	19.5	21.9	37.7	60.6
Hungary	21.5	23.0	31.8	48.2
Latvia	21.0	23.4	33.0	44.9
Poland	17.5	17.7	31.8	44.8
Romania	19.3	20.3	28.8	53.9

Notes) ¹ = 65+ years old % of 16-64 years old.

² = calculated by the ILO using the data of World Population Prospect of the UN (version of 98).

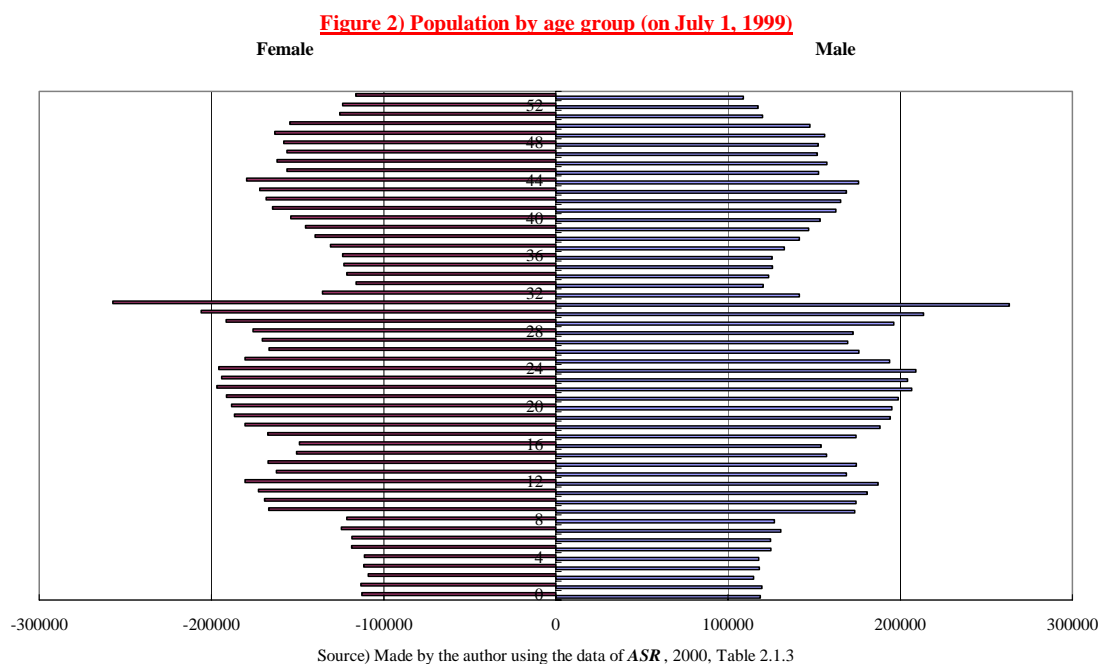
Source) Fultz & Ruck, 2001, p.22.

Table 2 also suggests that Romania is not a so young country like Albania as is expected from the level of economic development, but considerably mature society like Hungary and the Czech Republic from a demographic point of view.

Any designer of pension reform in transition countries could not make their policy without considering their quickly ageing population. For Romanians, however, it is also necessary to take a special condition of Romania, that is, the demographic legacy of Ceausescu. In November 1966 Ceausescu suddenly initiated pro-birth policy which caused the very high contingent fertility rate of 3.7 in 1967-68. The birth rate per 1000 habitants jumped up from 14.3 in 1966 to 27.4 in 1967. The birth rate had been kept at high level around 18.0-20.0 until the economic crisis in 80s. Even in 1989 the rate was 16.0 which can be considered still high by the international standard. From 1990 on, however, the birth rate has decreased continuously and it reached 10.4 in 1999 (*ASR*, 2000, Table 2.2.1).

Figure 2 shows this "legacy" clearly. There is an apparent fault line between age groups of 31 and 32. A person of 31 years old on July 1 of 1999 was born after the

initiation of Ceausescu's new policy. We can see one more line between 8 and 9. It indicates the anti-birth attitude of the people after the breakdown of the previous regime. Therefore we can call the age group of 9 to 31 on July 1 of 1999 as "Ceausescu age". "Ceausescu age" constitutes a bulk of the Romanian population and will enter the pension after 2029 (women) and 1932 (men).²



On the contrary, number of births since 1955 had been decreasing continuously until 1966, which also left clear trace on Figure 2. This generation will enter pension age in 2015 (women) or 2020 (men) and after.³ At that time the working generation born in 1967 and after will be still big enough to support the older generation. It seems to be an easing factor for the ageing problem of Romania pension reform. But it can be a trick for the policy makers of Romanian pension reform in the long run.

One conclusion here is that PAYG financing with DB plan cannot be sustained in Romania because of complicated structure of future Romanian population.

Employment

Table 3 indicates the change of the employment structure in several transition countries

² According to "the Law on the Public System of Pension" (No. 19/2000), age limit for pension will be raised from 62 to 65 (men) and from 57 to 62 (women) gradually during the period of 2001 to 2013 (men) and 2001 to 2021 (women) (Annex no.3).

³ According to the Annexed table of the Law 19/2000.

in 1989 and 1999. Here again the unique status of Romania is apparent. In Romania since 1989 through 1999 employment share of agriculture jumped up by more than 10 percent points although the employment share of agriculture decreased in the Czech Republic, Hungary and Poland. On the contrary, employment in industry decreased considerably in Romania whereas there were observed slighter decrease of employment in industry in the Czech Republic, Hungary and Poland. Thirdly it is true that the employment share of services increased in every country under review, but the increase of the share of service sector in Romania was smallest.

Table 3) Structure of Employment in Selected Transition Countries
(% of Total Employment)

	Agriculture		Industry ¹		Manufacturing ¹		Construction		Services	
	1989	1999	1989	1999	1992	1999	1989	1999	1989	1999
Bulgaria	18.6	26.2	37.7	26.5	ND	ND	8.3	4.1	35.4	43.2
Czech Republic	11.6	5.5	39.1	32.8	32.1	29.6	7.3	8.2	42.0	53.6
Hungary	18.3	7.5	30.0	28.0	25.8	24.7	7.0	6.2	44.7	58.3
Poland	26.8	25.2	29.0	23.4	21.0	19.7	7.8	6.1	36.4	45.3
Latvia	17.1	17.6	28.6	18.4	23.9	16.4	9.8	6.0	44.4	57.9
Romania	27.9	38.1	37.9	26.3	27.4	23.3	7.0	4.4	27.1	31.2

Note)¹ = "Industry" is larger category than "Manufacturing". The former includes the latter in it.

Source) UN, ECE, *Economic Survey of Europe*, No.1, 2000, p.106.

Bulgaria is the only country in the table whose structure is similar to that of Romania. But the increase of employment in agriculture in Bulgaria was smaller and the decrease of employment in service in Bulgaria was larger than in Romania. All these things suggest an important role of Romanian agriculture as shock absorber of labor problem in the transition period.

The role played by agriculture seems to be favorable precondition for social stabilization of Romania in the short run. In the long run, however, this would be a grave social burden because previous pension system for farmers in Romania was destroyed after 1989. Until the end of Ceausescu era most farmers in Romania were organized in agricultural production cooperatives and they had their own mandatory pension scheme. It was not long before the system went under serious financial crisis since the destruction of agricultural cooperatives after 1989. The cooperatives had provided the largest part of the pension fund. In 1992 a new law was issued to make an optional pension scheme of PAYG type. It, however, could not function well. Firstly, number of the farmers who subscribed the new pension scheme was very small (2.5-2.6 % of total number of farmers in June 1997). Thus, the contribution to the new pension fund has been too small to cover the system. Secondly the number of the pensioners retired from agricultural activities increased remarkably since 1990.

Therefore the real receipt of pensioners was much smaller than that of ordinal pensioners (Grigorescu, 1998, pp.10-12). In 2001 the number of the “Pensioners of Social Security” (it does not include farmers) was 4,544 thousand whereas “Pensioners of Agricultural Social Security” was 1,767 thousand”. Average monthly pension for the former pensioners was Lei 1,338,851 and for the latter Lei 271,651 (Magirescu, 2002, pp.20-21).

The increase of the share of agriculture in employment, therefore, means that a considerable part of Romanian people are now under vulnerable social assistance. The government, in turn, has to establish a stable pension system for agricultural people, but this task is more difficult in Romania than in other transition countries because the Romanian agriculture itself is now very vulnerable sector in the economy.

Table 4 shows unemployment rate of transition countries. From the view point of pension reform, unemployment rate is significant in a sense that unemployed people do not contribute to pension fund nor pay taxes to support pension system in general.⁴ Therefore the unemployment rate of Romania in Table 4 suggests that unemployment in Romania has had an unfavorable effect on the pension budget.

Table 4) Registered Unemployment in Selected Transition Countries
(% of labor force, end-of-period)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Albania	9.5	9.2	27.0	22.0	18.0	12.9	12.3	14.9	17.6	
Bulgaria	1.8	11.1	15.3	16.4	12.8	11.1	12.5	13.7	12.2	16.0
Czech Republic	0.7	4.1	2.6	3.5	3.2	2.9	3.5	5.2	7.5	9.4
Hungary	1.7	7.4	12.3	12.1	10.9	10.4	10.5	10.4	9.1	9.6
Poland	6.5	12.2	14.3	16.4	16.0	14.9	13.2	10.3	10.4	13.0
Latvia			2.3	5.8	6.5	6.6	7.2	6.7	9.2	9.1
Romania	1.3	3.0	8.2	10.4	10.9	9.5	6.6	8.8	10.3	11.5

Source) UN, ECE, *Economic Survey of Europe*, No.1, 2000, p.230.

In this relation the more important is the number of people who are not working by any reasons which includes not only unemployed people but also students, house wives, injured persons and others. Table 5 indicates the number of not working people at working ages. As the data of the second line includes people under 19 and over 60,⁵ the data of “number of not working people” as a difference between the first line and the second line are not meaningful as rigorously scientific data. But the trend of the data in the ten years is meaningful enough to take note. “The number of not working people at working ages” of Romania has tripled since 1990. It means that the number of the people who did not

⁴ Strictly speaking, employers would reduce their contribution to the pension system because of reduction of the number of workers.

⁵ The significant figure is also different.

contribute or only slightly contributed to the pension system has increased tremendously since the collapse of the previous regime. It can be named “decreasing working people problem.” But it is not a peculiar feature of Romania among the transition countries. Table 6 shows that the three Central European countries had suffered from the same problem. Romania is unique in a sense that the decreasing working people problem is connected with the increasing employment in agriculture. This is reflected in fiscal problems of the pension system.

Table 5) Number of Not Working People at Working Ages in Romania

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Population at Ages 20-59 ¹	12225665	12261908	11968143	11981470	12037202	12112010	12167337	12234362	12303316	12376639
Total Employed ²	10840000	10786000	10458000	10062000	10011000	9493000	9379000	9023000	8813000	8420000
Number of Not Working People at Working Ages ³	1385665	1475908	1510143	1919470	2026202	2619010	2788337	3211362	3490316	3956639

Note) ¹ = On July 1 of every year, ² = On Dec. 31 of every year, ³ = "Population at Ages 20-59" minus "Total Employed".
Source) ASR, 2000, Table 2.1.3, Table 3.1.1.

Table 6) Number of Not Working People at Working Ages¹ in Central Europe (in thousands)

	1989	1990	1991	1992	1993	1994	1995	1996
Hungary	841	723	839	1257	1629	1797	1898	1966
Poland	2464	3755	4754	5484	5944	5937	5831	5724
Czech Republic	53	79	394	569	709	753	707	754

Note) ¹ = See Note 3 of Table 5.
Source) Schrooten, Smeeding and Wagner, 1999, p.281.

Fiscal deficit and inflation

Tables 7 - 10 show the financial aspects of social security of the four transition countries using the data of ILO research project.⁶ Here the overall balance of the Czech Republic and that of Romania form a striking contrast. Romanian data recorded a considerable amount of overall deficit on social security program, whereas the Czech Republic has gained fiscal surplus.⁷ Katharina Mueller asserts that fiscal deficit of pension

⁶ Data of Poland for 1994-1996 are missing from the data series of ILO.

⁷ In Tables 7-10, “Social protection benefits” except “Old-age benefits”, “Survivors’

system in Hungary and Poland led to their radical reforms of Latin American type and that fiscal surplus in the Czech Republic led to its moderate reform (Mueller, 1999). Along with this line of thinking, we would expect Romanian pension reform to be radical one. But the reality is more complicated.

Table 7) Social Security Cost: Hungary (% of GDP)

		1994	1995	1996
Expenditure	(1)Total	26.10	22.49	20.90
	in which			
	(2)Social protection benefits	25.28	22.01	20.41
	in which			
	(3)Old age	7.05	6.36	5.93
	(4)Survivors	1.32	1.17	1.07
	(5)Invalidity benefits	2.69	2.48	2.35
	(6)Administrative cost	0.40	0.41	0.46
Receipt	(7)Total	24.80	21.75	19.93
	in which			
	(8)Old-age, invalidity and survivors' program	9.48	8.70	8.02
Balance	Overall:(2)-(1)	-1.30	-0.74	-0.97
	Old-age, invalidity and survivors' program:(8)-((3)+(4)+(5))	-1.58	-1.31	-1.33

Source) ILO, *International Inquiry into the Cost of Social Security 1994-1996*
 [Webpage of the ILO, <http://www.ilo.org/public/english/protection/socsec/publ/css/>]

benefits” and “Invalidity benefits” are benefits for “employment injury”, “sickness and health”, “family”, “unemployment”, “housing” and others.

Table 8) Social Security Cost: Czech Republic (% of GDP)

		1994	1995	1996
Expenditure	(1)Total	12.43	12.17	12.48
	in which			
	(2)Social protection benefits	12.15	11.84	12.20
	in which			
	(3)Old age	5.49	5.67	5.62
	(4)Survivors	0.97	0.91	0.90
	(5)Invalidity benefits	1.51	1.60	1.60
	(6)Administrative cost	0.28	0.33	0.28
Receipt	(7)Total	12.15	16.32	15.80
	in which			
	(8)Old-age, invalidity and survivors' program	8.52	9.10	9.44
Balance	Overall:(2)-(1)	-0.28	4.15	3.32
	Old-age, invalidity and survivors' program:(8)-((3)+(4)+(5))	0.55	0.92	1.32

Source) ILO, *International Inquiry into the Cost of Social Security 1994-1996*

[Webpage of the ILO, <http://www.ilo.org/public/english/protection/socsec/publ/css/>]

Table 9) Social Security Cost: Romania (% of GDP)

		1994	1995	1996
Expenditure	(1)Total	12.84	13.71	12.45
	in which			
	(2)Social protection benefits	12.50	13.35	12.02
	in which			
	(3)Old age	5.39	5.51	5.58
	(4)Survivors	0.60	0.64	0.64
	(5)Invalidity benefits	0.56	0.55	0.50
	(6)Administrative cost	0.43	0.36	0.34
Receipt	(7)Total	8.96	8.90	8.39
	in which			
	(8)Old-age, invalidity and survivors' program	8.96	8.90	8.39
Balance	Overall:(2)-(1)	-3.88	-4.81	-4.06
	Old-age, invalidity and survivors' program:(8)-((3)+(4)+(5))	2.41	2.20	1.67

Source) ILO, *International Inquiry into the Cost of Social Security 1994-1996*
[Webpage of the ILO, <http://www.ilo.org/public/english/protection/socsec/publ/css/>]

Table 10) Social Security Cost: Bulgaria (% of GDP)

		1994	1995	1996
Expenditure	(1)Total	11.72	10.29	9.04
	in which			
	(2)Social protection benefits	11.66	10.23	8.98
	in which			
	(3)Old age	8.67	7.31	6.57
	(4)Survivors			
	(5)Invalidity benefits	0.90	0.86	0.70
	(6)Administrative cost	0.05	0.05	0.05
Receipt	(7)Total	8.96	8.90	8.39
	in which			
	(8)Old-age, invalidity and survivors' program	ND	ND	ND
Balance	Overall:(2)-(1)	-2.76	-1.39	-0.65
	Old-age, invalidity and survivors' program:(8)-((3)+(4)+(5))	-	-	-

Source) ILO, *International Inquiry into the Cost of Social Security 1994-1996*
[Webpage of the ILO, <http://www.ilo.org/public/english/protection/socsec/publ/css/>]

The point is that Romania kept surplus in the fiscal balance of “old-age, invalidity and survivors' program” in appearance. This was caused by limited amount of benefits. At first we must note that benefits for survivors and invalidity benefits in Romania are much smaller than those of other transition countries. A life of widow or invalid without job is miserable in Romania. According to Grigorescu’s calculation, the percentage of invalids’ and survivors’ pensioners under minimum living standard were 95-100% (depends on the grade of invalidity) and 99.5% respectively in December 1998 (Grigorescu, 1999, p.22). Secondly, pension for old-age people in Romania was small if calculated as a percentage of GDP. Although the figures of the Czech Republic are similar to Romania’s figures, we must consider that the per capita GDP of the Czech Republic is twice as much as that of Romania. Therefore we can conclude that the Romanian government kept the pension benefits at very low level to attain the apparent surplus in pension system balance though the overall fiscal balance of social security was in deficit.⁸

The amount of pension can be compared by statistics of “replacement rate”. We adopt

⁸ Other data source indicates that the budget of state pension fell into deficit after the change of government in the end of 1996 (ASR, 2000, Table 17.3).

here the definition that replacement rate is average pension in percent of average wage. Table 11 shows the replacement rates of several transition countries in this sense. It is clear that the replacement rate of Romania was very low under Ceausescu and that it has even declined under the new regime. Comparing with Romania, the governments of the three Central European countries have made some efforts to keep living standard of their pensioners. Especially it is impressive that in Poland the replacement rate was raised by more than 10 % points in 1991, which can be attributed to the character of Solidarity's government.

Table 11) Replacement Rate of Pension in Selected Transition Countries¹

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Hungary	63.3	63.8	64.0	60.8	57.4	54.8	57.9	56.7		
Poland	53.3	65.0	76.1	72.5	72.8	74.8	74.5	72.5		
Czech Republic	63.8	65.2	70.4	67.7	60.5	57.2	56.6	56.0		
Romania	46.7	44.7	45.1	43.6	45.2	42.6	40.8	38.6	40.0	36.2

Note) ¹ = "Replacement rate" means average pension in % of average wage.

Source) Hungary; Poland; the Czech Republic: Schrooten, Smeeding and Wagner, 1999, p.282.

Romania: Grigorescu, 1999, p.25.

The deterioration of replacement rate in Romania is connected with poorly organized indexation of pension under the circumstance of hyper inflation. So we must examine the relationship between inflation and pension in Romania.

According to Table 12, the inflation rates of Bulgaria and Romania have been the highest in the table. Romania shows a peculiarity that it has never recorded a rate lower than 30% in any year since 1991. Especially Romania is special in a sense that its inflation rate was still high in 1998 and 1999 when the inflation in other countries was stabilized. Naturally these things affected the process of pension reform in Romania seriously.

Table 12) Consumer Prices in Selected Transition Countries
(Annual average, percentage change over precedeng year)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Albania		35.5	193.1	85.0	21.5	8.0	12.7	33.1	20.1	-0.1
Bulgaria	23.8	338.5	91.3	72.9	96.2	62.1	123.1	1082.6	22.2	0.4
Czech Republic	9.9	56.7	11.1	20.8	10.0	9.1	8.9	8.4	10.6	2.1
Hungary	28.9	35.0	23.0	22.6	19.1	28.5	23.6	18.4	14.2	10.1
Poland	585.8	70.3	45.3	36.9	33.2	28.1	19.8	15.1	11.7	7.4
Latvia	10.9	172.2	951.2	109.1	35.7	25.0	17.7	8.5	4.7	2.4
Romania	5.1	170.2	210.7	256.2	137.1	32.2	38.8	154.9	59.3	45.9

Source) UN, ECE, *Economic Survey of Europe*, 2000, No.1, p.231.

Table 13 shows that the real pension (of state) of Romania has been decreasing continuously. It means that the raise of nominal pension could not catch up with the speed of inflation though some efforts to adjust the relation between pension and prices have been made by the government (which is called “recorelarea” [re-adjustment]). Concerning the measures of re-adjustment it is worth noting that decrease of real pension was compensated by the method of lump-sum payment in the first years of the transition. For example, in July 1996 after the increase of the prices of energy, fuel and bread, compensation for most of pensioners was made with payment in lump sum of 8000 lei. Such measures produced a curious result, that is, equalization of earnings of pensioners. Although the equalization seems to have a good stabilizing effect in a society, it would damage people’s belief in the public pension system by weakening the relation between contribution and benefit. Therefore the overall indexation of pension with the same percentage for all the categories of pensioners was introduced in October 1996, December 1998 and March 1999 (Grigorescu, 1999, pp.28-29). These re-adjustment measures, however, generated another serious problem that pension earnings are different according to the timing of retirement.

Table 13) Real Pension Index of Romania

	Average real pension of social security of state ^{1,2}	
	Total pension	Old-age pension with full service ³
Oct. 1990	100.0	100.0
Dec. 1990	73.3	72.7
Dec. 1991	74.3	64.8
Dec. 1992	62.8	58.2
Dec. 1993	54.3	51.4
Dec. 1994	56.9	53.8
Dec. 1995	61.5	57.8
Dec. 1996	58.3	55.0
Dec. 1997	48.4	45.8
Dec. 1998	52.5	51.5
Mar. 1999	48.7	47.8

Notes)

¹ = Nominal pension index / Consumer price index
[level of both indices at Oct. 1990 = 100]

² = Consumer price index used here is different from the index in Table 12.

³ = Without supplementary pension

Source)

Calculated by the author from the data of Grigorescu, 1999, p.12.

Romania has been suffering from unstable macro economic situation of inflation until recently whereas other transition countries had got out of such problems. Therefore the Romanian government could not do anything but cope with current problems of the system.

Financial market

A well organized financial market with considerable scale is indispensable to functioning of the second pillar pension system recommended by the World Bank because the second pillar is based on funded money which should find investment opportunity especially in domestic market. Until recently Romania had not been ready to introduce the second pillar in this regard.

Table 14 indicates the short-term interest rates of transition countries. It is true that

the short-term interest rates reflect many factors of an economy and some difference of the rates among several countries cannot be attributed to one reason. Notwithstanding, if one country's rate is significantly higher than that of other country during some years, it is a symptom of structural difference of the financial markets. In Table 14 Romania shows a unique status, whose interest rate had been high until the late 90s. It can be attributed to high inflation in Romania. It means that those who want to invest their financial resources into domestic market in Romania must take high risk. It is unfavorable condition for introduction of private pension fund which is the essential element of the second pillar of pension system. Of course the pension fund would invest not in short-term but in long-term financial market and the high level of interest rate in Romania should be lowered in the long run as the macro economic situation would be stabilized. However, the difference of interest rates in Table 14 is so large that we can suppose structural weakness of Romanian financial market.

Table 14) Short-term Interest Rates in Selected Transition Countries (%)

	Short-term credits				Short-term deposits (domestic currency)				Average yield on short-term government securities			
	1996	1997	1998	1999 ¹	1996	1997	1998	1999 ¹	1996	1997	1998	1999 ¹
Bulgaria	300.3	209.8	14.1	13.6	146.4	80.8	3.0	3.3	278.7	200.8	6.2	5.6
Czech Republic	12.5	13.2	12.8	8.7	6.8	7.7	8.1	4.5
Hungary	27.3	21.8	19.3	16.3	22.2	18.5	16.1	13.3	24.0	20.1	17.7	14.7
Poland	26.1	24.9	24.6	16.8	18.5	18.1	17.4	11.0	20.3	21.6	19.1	13.1
Latvia	25.8	15.2	14.3	14.2	11.7	5.9	5.3	5.0	16.3	4.7	5.3	6.3
Romania	55.3	72.5	55.4	66.0	38.1	55.8	37.3	46.4	51.1	85.7	64.0	74.4

Note) ¹ = January-November for Poland and Romania.

Source) UN, ECE, *Economic Survey of Europe*, 2000, No.1, p.49.

In Table 14 it is impressive that figures of Bulgaria decreased suddenly in 1998. It was caused by the introduction of currency board system in July 1997. After that Bulgaria experienced financial stability and unemployment problems at the same time. It gives an interest suggestion for Romanian pension reform because the Bulgarian case indicates that a currency board system would bring financial stability of a country which must be favorable condition for the establishment of private pension funds, but also teaches that unemployment would occur under currency board system which can produce unstable effects on pension system and the social security system as a whole. In reality, there were active disputes as for the introduction of currency board system in Romanian Parliament in 1998-99 and most of political parties came to be against the introduction.

Maturity of financial market of a country can be estimated by share of monetary aggregates in GDP. Generally speaking, the more a country is advanced in economic

development, the higher the share in the country becomes. The increase of the share is closely connected with so-called “financial deepening”. According to Table 15, the financial deepening in Romania has not advanced so much as in other countries. This suggests immaturity of Romanian financial market which would be a grave obstacle to transition from PAYG to funded financing of pension system.

Table 15) Share of Monetary Aggregates¹ in GDP of Selected Transition Countries (%)

	M1 ²				Total broad money ³				Total credit ⁴			
	1996	1997	1998	1999 ⁵	1996	1997	1998	1999 ⁵	1996	1997	1998	1999 ⁵
Bulgaria	7.4	6.5	10.2	11.5	44.4	23.9	27.9	29.3	34.5	17.4	16.3	17.2
Czech Republic	28.4	25.4	22.2	24.2	68.1	68.5	67.4	71.5	61.9	64.4	62.6	58.9
Hungary	15.2	14.7	15.2	15.6	36.4	35.6	40.3	40.7	22.9	24.2	24.6	26.2
Poland	10.9	13.9	13.5	14.4	33.5	41.2	43.5	47.9	17.2	20.4	22.9	25.8
Latvia	12.4	14.1	15.2	15.2	19.7	22.5	24.2	24.2	7.3	8.9	13.7	15.9
Romania	7.3	5.0	4.7	4.2	20.8	18.3	19.3	20.2	19.2	14.8	13.4	12.7

Notes) ¹ = Averages of monthly or quarterly figures.

² = Currency in circulation plus deposits.

³ = M1 plus time deposits in domestic currency and foreign currency deposits.

⁴ = Total outstanding claims on firms and households (except claims on government).

⁵ = January - November for Poland; GDP data for 1999 are based on preliminary report by national statistical office, or estimates.

Source) UN, ECE, *Economic Survey of Europe*, No.1, 2000, p.50.

As for the immaturity of Romanian financial market, we can find much institutional evidence. For example, privatization of banks is least developed in Romania among transition countries. In 1998 the assets share of state-owned banks in Romania was 74.6%, whereas 66% in Bulgaria, 18.8% in the Czech Republic, 11.8% in Hungary, 8.5% in Latvia, 48% in Poland (Schroeder, 2001, p.90). Concerning security market infrastructure, no bonds was traded in Romania as of 1998 whereas some kind of bonds (including government bonds) markets including OTC markets are settled in Bulgaria, the Czech Republic, Hungary and Poland (Schroeder, 2001, pp.114-115).

One solution to the problem of limited capital market in Romania is to resort to foreign capital. However this strategy is not fully considered by the policy makers of Romania. The Emergence Ordinance No.230 (Nov. 2000), which was a legal document to stipulate organization and operation of the second pillar and was canceled right after the publication, had a provision that the pension fund could not invest in foreign assets more than 20 % of the total value of the fund assets and that the foreign investment must be limited to government bonds (Art.109-110). The Romanian policy makers fall into a dilemma between safety and prosperity of private funds system.

Concluding remarks

In Romania establishment of the three pillar system has not been tried seriously. Even the full reorganization of the first pillar was delayed and had not been accomplished until April 2001.⁹ The crisis that Romania faces in the sphere of pension reforms is totally different from that of Central European countries. The latter is a creeping crisis, importance of which is not fully realized by the people now, but it will make grave social problems in the future if we leave the system unchanged. The crisis of Romania is the crisis which exists now and here. This crisis was brought about not only by Ceausescu's legacy but also the governments until 1996 because they relaxed the entrance conditions of pension and made a lot of pensioners (Menil and Sheshinski, 2000, pp.69-71). They are also responsible for the crisis because they could not pursue stringent macro economic policy and could not suppress the inflation. Notwithstanding, we must also note that the more liberal oriented governments after the 1996 election could not stop the inflation either. Who was responsible is not important but to resolve today's problems is important. Now in Romania we have a complicated structure of pension with low replacement rate, high share of agricultural pensioners, increasing budget deficit, poorly organized indexation and people's low reliance on the system. The difficulty of Romanian pension reform, especially the organization of the relationship between the first pillar and the second pillar lies in this point.

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⁹ The law for the first pillar was named "Law on the Public System of Pension and other Social Security Benefits" (No.19/2000), which was adopted by the Parliament in February 2000 but came into effect one year later.

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