PN-ABF-759

Romania:

Background Notes on the Housing Sector in a Reforming Economy

July 1990

Prepared by:

William F. Barnes, Jeffery P. Telgarsky
The Urban Institute

for the:

Office of Housing and Urban Programs
U.S. Agency for International Development
Washington, D.C. 20523

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The Urban Institute
2100 M Street, N.W.
Washington, D.C. 20037

UI Report 6062-02C
Contract #: PDC-1008-I-00-9067-00

DEMOGRAPHIC AND ECONOMIC OVERVIEW[1]

The Romanian economy, after strong growth in the 1970's and early 1980's, has faltered badly in the past two years. Its medium-term prospects are difficult to judge because of the unsettled political situation and unknown time that will be required to redeploy resources from the vast projects of the prior regime. Nevertheless, some small but clear steps have been taken towards economic reform.

Population

Romania's population is 23 million. In the 1980s the country's population increased but at a declining rate. The population grew at about 0.9 percent in the 1970s and about 0.5 percent per year in the 1980's. Romania has a pro-natal policy and imposes additional taxes on singles and childless couples. The low population growth rate may be due to a decline in the birth rate (19.7 per thousand in 1975 to 14 per thousand in 1983). The death rate has also increased slightly -- 9.3 per thousand in 1975 to 10.0 per thousand in 1983. But better demographic data on the size of age cohorts in the population is needed to separate age these effects from changes in birth and death rates. However, the change in both rates may simply be due to lower living standards.

Organizational Reforms

Prime Minister Petre Roman announced late in June he would carry through with Romania's "historic transition from a super-centralized economy to a market economy". Immediately following the December revolution the interim Romanian President, Ion Illiescu, announced that Romania would become a "free enterprise" country but five years would be needed to achieve the objective. However, concrete signs of movement have dried-up and Romania seems to be deviating from the economic and political reform patterns of other Eastern European countries.

The election of Ion Illiescu and a National Salvation Front (NSF) majority in the National Legislature on May, 1990, was, at least in part, a mandate for the Romanian government to move slowly and ensure against economic disruption.[2]

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1 Unless otherwise indicated economic data are from EIU (1989, 1990).

2 On May 20th the Romanians elected Ion Illiescu president and members of the National Salvation Front Council to preside over the National Legislature. Illiescu, an ousted Communist who worked for Nicolae Ceausescu, received eighty-five percent of the votes. The National Salvation Front won about two-thirds of the seats in both legislative houses; the NSF leadership and most council candidates had formerly been Ceausescu officials, ousted before the revolution.

New cabinet ministers, NSF members; were announced late in June; but the role for opposition parties in the new government is still highly uncertain. Since the revolution, there has been very little public discussion about possible economic change within Romania. A related concern is the chilling effect of the government on debate.[3]

Romania remains one of the most isolated Eastern European countries. However, Romania has applied to become a member in the World Bank. Since the country was previously a member, this would technically be readmission. Romania is presently a member of the IMF.

Aside from the country's debt reduction efforts (described below), Romania's most well known policy was Ceausescu's ambitious population relocation program. Romania's 23 million people were to be "systematized". The population of one-half of Romania's 13,000 villages was to be relocated to 600 "agro-industrial towns" and several thousand "commune centers". The program also involved redesigning and destroying parts Romania's central cities (Hunya, 1989).

The NSF interim government halted investment in "systematization". The resources wasted in pursuing the program were enormous. Existing infra-structure was destroyed and more than one-half of Romania's employees in the construction sector worked on the projects.

Private Sector

Romania has permitted the private ownership of homes and family businesses. In January the government announced that the scope of private ownership would be expanded. Private businesses, on a limited basis, were legalized. Joint foreign ventures have been encouraged by Romania with little success since 1971.

The NSF issued an order permitting restricted private enterprise. Establishments with less than 20 employees are to be allowed; plans call for free market prices in the private enterprise sector. In addition, some state employees are to be allowed to work part-time in private enterprises.

Immediate reforms were directed at Romanian agricultural because the sector has been performing poorly. Cooperative farms will be allowed to establish limited

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[3] The most well-known example is the clash between students and miners whom had been transported to Bucharest by Illiescu to end a strike. He has since renounced any illegal actions which the miners undertook.

private plots, and houses on the plots may also be converted to private property (which can be sold so long as the land is cultivated). This reform, at least in part, codifies previously existing practices.

Economic Performance

The Romanian economy achieved a high rate of industrial growth in the postwar period. But the remarkable growth, reported to run at 7 to 8 percent a year, was achieved at considerable sacrifice of consumption. More recently the economy has faltered badly.

By the 1980s Romania's growth strategy had lead to a large foreign debt. The growth strategy used funds borrowed from foreign lenders to develop a number of industries—such as engineering products, apparel, appliances and refining. The industries and the strategy were, in hindsight, bad choices. Romania's external debt was swollen by energy demands and high interest rates. The foreign debt, combined with Ceausescu's obsession to eliminate it, has disabled the Romanian economy.

Table 1 presents data available on recent economic performance. In 1989, national income, investment and output all exhibit sharp declines. Nonetheless, the current account continues to show a US$2.3 billion surplus.

Table 1
Domestic Economic Indicators
(percent change from previous year)

	1987	1989[a]	1990[b]
National Income (NMP)[4]	4.8	-5.0	-10.0
Gross Fixed Investment	2.5	-10.0	-10.0
Industrial Output	4.5	-5.0	-10.0

a: Estimated; b: Projected

[4] NMP is a national income measure similar to GDP, but accounts only the material value of output (i.e., NMP is equal to GDP less: excess value of non-material services (domestic and net imported); consumption of fixed capital; and transfer costs of existing fixed capital (see United Nations, 1989b).

This year shortages in energy have crippled industrial production. The Romanian government reported in January of this year that shortages -- coal, natural gas and electricity -- have limited the use of the country's industrial capacity by about 20 percent. However, at the same time the amount of electricity allocated to consumers was doubled.

Industrial Composition

The bulk of Romanian Net Material Product (NMP) is industrial (e.g., heavy machinery). Table 2 presents employment by industry. Employment figures confirm the importance of Romania's industrial sector. The second largest category is still the agricultural sector. Prime Minister Roman has stated that technology in the industrial sector is 40 years old and the agricultural technology is even more antiquated.

Table 2
1986 Sector Employment

	Employment (thousands)	Employment (percent)
Agriculture	3,062	28.7
Industry	3,980	37.3
Construction	790	7.4
Transport	736	6.9
Trade	619	5.8
Others	1,483	13.9
Total Employment	10,670	100.0

Prices and Imports

Inflation well in excess of 10 percent is expected for 1990. How this compares with prior years in unclear, since the Romanian Labor Minister has said that wages levels will be maintained. The Romanians have not produced inflation data since the mid-1980s.

Price controls have not been lifted systematically; but some prices are being selectively reduced. Romanian prices provide unusually poor market signals. For example, electricity was available to residences only a few hours a day under Ceausescu's. The price of electricity was lowered 98 percent to households after

Ceausescu's ouster.

Romanian imports have risen dramatically in the past few months; the constraint on imports is reported to be the physical capacity to unload them. Consumer goods now showing up on shelves in Romania are often labeled "for export only"—left-overs—from Ceausescu's draconian export program.

Fiscal Policy

The foreign debt repayment program Ceausescu imposed dominated Romania's economy in the 1980s. The combination of high interest rates, high petroleum prices, and the selection of losing industries generated a large foreign debt. The Romanian foreign debt reached the order of US$10 billion by the end of 1981. Romania has reduced the debt to less than US$1 billion, a remarkable achievement, but this has virtually bankrupted the Romanian economy.

Ceausescu applied draconian, uneconomic measures to force the reduction. Imports in 1989 were 25 percent the amount in 1985. Two examples should clarify. (1) Plants were closed because a foreign part was needed for repair. (2) Fuels available in Romania were substituted for foreign fuels, even if the domestic fuels caused the boilers to burn out once every year rather than every 5 years. Romania's physical plant is aged. Romanians speak of the "inheritance" left their country by Ceausescu -- referring to the crumbling industrial plant and state infrastructure.

Over 95 percent of Romanian government revenues come from taxes paid by enterprises. Taxes on individuals were decreased through the 1980s; however, about 15 percent of revenues were raised from taxes levied on SOE wage funds. The SOEs have also provided many of the social services, for example, health, education, housing, and pensions.

Financial and Banking System

Romania's financial system is primitive but illustrates the standard model in centrally planned economies. Romania has a two-tier banking system; (1) the Romanian State Bank (central bank) and (2) specialized banks. The central bank conducts macroeconomic policy; the guiding policy has been to equate disposable income with the value of consumer goods to prevent inflation. The specialized Romanian banks provide credit on a pass-through basis from the central bank to the borrowing client.

The Romanian State Bank, the central bank, has local branches. The central bank, its branches and the specialized banks are virtually arms of the public treasury. The banks direct funds to accommodate client plans; the client plans provide the instructions for a command economy. The branch banks simply compare firm requests to firm plans and monitor implementation. Hence, there is no loan underwriting. After they have occurred, Banks often record exchanges between firms simply as bookkeeping transfers. Money is primarily a unit of measure.

Specialized banks include the Investment Bank, the Agricultural Bank, the Foreign Trade Bank and the Savings and Deposit Bank. The Savings and Deposit Bank (and its branches) receive deposits from individuals and municipalities, siphoning-off liquidity. The Savings Bank lends the deposits to the State Bank (central bank). The State Banks typically has used the funds for housing loans. The Investment and Agricultural Banks distribute investment funds according to the central plan.

Interest rates are arbitrarily set by the Central Bank. In recent years the rates have been raised; however, interest rates have not been used to allocate investment. Recently there has been some consideration of allowing enterprises to issue equity shares or bonds, but these financial instruments are not currently available. Romania has no financial market and virtually no institutions other than the structural "shells" provided by the banks.

The currency, the lei, is not convertible. Romania has announced no plan or intention to move toward convertible currency and so the country's economy is likely to remain isolated. The country continues to be a highly centrally planned economy with little orientation to free market operation. Reforms are designed more to fill in gaps left in the socialist economy than to be basic structural changes.

THE HOUSING SECTOR

Housing Production and Delivery

Romania has the smallest share of resources (relative to national income) devoted to the housing sector of any East European country. (The German Democratic Republic has similarly low levels, but in 1985 showed production levels per capita almost three times higher than Romania). In 1985, housing investment in Romania amounted to 2.3 percent of net material product (NMP, similar to GDP), less than half the share in Poland and Hungary; 6.1 percent and 5.4 percent, respectively (United Nations, 1988).

In terms of national investment, Romania again shows the lowest share in Eastern Europe, devoting only 8.1 percent of total investment to housing in 1985. All other countries in the region devoted more than 12 percent of their total investment to housing—more than 20 percent of total investment in Poland and Hungary is for housing. Productivity in the sector has also fallen, as the number of units constructed fell by 47 percent between 1985 and 1980 while the volume of resources devoted to housing decreased by only 37 percent in real terms (United Nations, 1988).

Housing in Romania has always been a central part of Romanian social policy, both in terms of resolving persistent housing shortages and achieving the state's desired pattern of urbanization. Under the Ceausescu regime, the country undertook a massive program of reconstruction and consolidation of cities, towns, and villages. The key components of these plans were the clearing of city centers of their historic buildings and replacement with new street networks and large blocks of commercial and residential buildings. In rural areas, the plans called for relocation of thousands of persons (cutting the number of rural villages from 13,000 to about 6,000) and replacing existing rural housing with blocks of flats (Hunya, 1989). These programs have since been stopped by the new administration.

These programs explain the large bias towards urban areas for new housing construction. During 1976-80, of the 841,800 new housing units built, just under 90 percent were built in rural areas—despite the fact that only about half the population still lives in rural areas (Miskiewicz, 1986).

Production of housing has been unable to keep up with the formation of households; the number of new units produced in 1985 represented on 54 percent of the number of new households created by marriage and divorce that year (United Nations, 1988). This global measure understates the housing shortage, since it does not take account of the number of units lost from the housing stock due to clearing sites in city centers or consolidating rural settlements or the number of households dissatisfied with the quality of their present housing.

For example, in Bucharest, the waiting list for new housing numbers over 100,000 applications, which could represent as much as 15 percent of the city's 2.3 million residents. Most of these applications represent households which are seeking better quarters (Nankman, 1990). However, there are few options for these households. Even private individuals who undertake the risk of contracting with SOEs to build dwellings have to wait about 2-3 years after the order is placed for the work to be carried out (Dorin, 1990).

One strong indication of the housing shortage is the number of persons living in single workers' hostels: 561,000 in 1984. These hostels lack basic facilities, such as kitchens, but are often used by young households even after marriage as no other shelter is available. Many residents have spent up to 10 years in a hostel waiting for a proper housing unit (Miskiewicz, 1986). In addition to the hostels, there are significant numbers of workers who live in other temporary shelters on construction sites and at forestry and oil-extraction operations.

Housing production in 1985 (106,000 units) was 47 percent lower than production in 1980 (198,000 units). This downward trend in annual production partially explains the fall in total production by 16 percent during 1981-85 (706,000 units) compared to the previous five years (United Nations, 1988; Miskiewicz, 1986).

Construction Industry

Housing in Romania is produced both by the socialized sector (which includes the state, state-owned enterprises (SOEs), and cooperatives) and by private individuals. In 1980, the socialized sector accounted for 94 percent of all new housing; the private sector produced only 11,200 units that year (United Nations, 1988). These units were built almost exclusively in rural areas, as building individual units in urban areas was prohibited.

Housing built by the state over the past 40 years has conformed to a limited range of standardized flats in large blocks. At present, they are built to three basic standards with up to 5 habitable rooms, kitchen, and 1-2 bathrooms. Floor space ranges from 24 square meters for a "low-comfort" one-room unit to 171 square meters for a five-room "increased-comfort" unit. Units with 3-4 rooms (ranging from 100 to 150 square meters) are most in demand. The production of flats with shared kitchen and bath facilities was stopped a few years ago and such units are now being renovated into larger and better-equipped flats (Nankman, 1990).

Housing quality is a serious problem. Official statistics indicate that the amount of floor space per person increased from 31.9 square meters in 1970 to 35.2 square meters in 1980 (Miskiewicz, 1986). However, the quality of construction has declined considerably over the past 15 years and that of new units is extremely poor, due to lack of skilled labor, inadequate supplies of materials and spare parts, and poor management of time and equipment. One observer (Gilberg, 1990) stated that the quality of construction and materials was so poor that many new blocks of flats were slums even before the scaffolding was taken down.

The private sector construction industry did not formally exist before 1989, when legislation allowing the creation of private enterprises was enacted. However, most private activity is still carried out as it was previously: small-scale, part-time sidelines by workers with formal jobs in the state construction sector. Private sector construction costs are about 4,000 to 5,000 lei per square meter (US$33 to US$42 per square meter at the current mean unofficial exchange rate of 120 lei per dollar), significantly higher than reported public sector units costs of 3,000 lei per square meter (Nankman, 1990). The public sector cost probably reflects some scale economies, but also probably includes hidden subsidies; the higher private sector costs can partially be explained by the higher prices paid for labor and material as well as the more speculative nature of the work. The price differential illustrates how different the operating conditions are that the two sectors face.

Private construction is currently confined to private land and no public land, serviced or unserviced, is being made available for private development. There is no sign of any near-term change in this policy, though the possibility of serviced, leasehold plots for individual construction by young families and first-time owners has been raised.

Housing Allocation and Tenure

The trend in housing tenure in Romania during 1948-89 has been towards greater constriction of private control over the housing stock. Nationalization of housing in 1948 restricted private ownership to one unit per household, with most other units confiscated and turned into public sector housing (Nankman, 1990).

It has been possible (in theory) since 1973 for private individuals to construct and purchase individual dwelling units (either from other individuals or from the state). However, as Dorin (1990) reports, the legislation was not followed by adequate contractual and administrative procedures for its implementation. As a result, further legislation to protect the rights of purchasers (mainly to give recourse against poor-quality construction produced by the SOEs) was promulgated in 1977. Neither of these measures led to an appreciable increase in the number of flats and houses being built, as households found legal recourse difficult and usually ended up simply paying for the necessary repairs themselves. In practice, most private sector activity since the 1970s has focused on renovation of existing privately-owned buildings.

During 1979-85, tenants were able to buy, under very favorable terms, the rental flats which they occupied. Sales were suspended in 1985 as part of a generalized drive against private ownership. Under current law (as modified in 1990), these sales have been allowed again, with the intention of both absorbing excess liquidity in the economy and responding to popular demand for housing ownership. The proceeds from the sale of state-owned flats transferred to the central government. However, the property rights associated with these sales are confused; for example, the sites on which multi-family units sold to their occupants were constructed remain owned by the state while the units themselves are owned by their occupants. The lifting of restrictions against the sale of public and private dwellings in 1990 has revived the real estate market and, although no figures are yet available, bought about signs of significant activity (Nankman, 1990).

Housing Finance

Rents on state-owned flats are determined by a formula which takes into account the tenant's income, household size, and floor area (but not location). Typical rents range from 100 to 1,000 lei per month (US$4.55 to US$45.50 at the present official exchange rate of 22 lei per dollar) and represent about 10 percent of household incomes (Nankman, 1990). Dorin (1990) estimates that rents on state-owned flats are about half of free-market rents. This would be much closer to market levels than rents in other East European countries. These higher rents are partially explained by the Romanian legal standard of 10 square meters of housing per person; Households living in units which exceeded this standard pay significantly higher rents.

Finance for housing purchase during 1979-85 was provided through the Romanian Bank for Investments. Loans were structured according to salary and size of unit: downpayments increased from 20 percent to 30 percent and loan terms fell from 25 to 15 years as salaries rose; loan ceilings ranged from 35,000 lei (US$2,300 at the 1981 official exchange rate) for a one-room flat to 90,000 lei (US$6,000) for a five-room flat; and interest rates ranged from 3 percent to 8 percent according to the type of loan granted. It was also possible, in rural and some urban areas, for households to obtain a loan of 25,000 lei (US$1,700) for building their own unit. In most urban areas, though, the household could only qualify for a loan if they were buying an existing unit or one built by a SOE developer; no financing was available for individual construction (Dorin, 1990).

In 1990, the restrictions on housing purchase were lifted and households were allowed to obtain credit from state banks to finance individual unit construction. Finance for housing purchase remains almost entirely in the hands of the state with no increases in credit for the private housing sector evident. Current mortgage loans have terms of 20-25 years, loan-to-value ratios of 70 percent and higher, and annual interest rates are between 2 and 6 percent; the official inflation rate is under 2 percent annually, but actual inflation appears higher. Prices are very low: in May 1990, single family units with 300-400 square meters of floor space in better locations in Bucharest were selling on the private market for between one and two million lei (US$8,500 to US$17,000 at the unofficial exchange rate). In-fill sites in similar locations were selling for 1,200 lei (US$10) per square meter. It is not yet known how deep this market might be, as the true scope of land and properties in private hands is only now being assessed.[5] In addition, most privately-owned buildings are at least 20 years old (with the majority constructed about 40 years ago) and in varying states of disrepair.

Future Directions for Reform

No statement has yet been made on housing policy, but Nankman (1990) outlines the following probable features of future reforms in the Romanian housing sector:

- Continued strong state involvement, especially on the production side, but targeted more narrowly on the middle- and lower-income sections of the population. A country-wide program of 85,000 units to be built by local authorities has recently been approved. The units would mainly be 100 square meter rental units with monthly rents set at 400-500 lei (with

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[5] Apparently, the cadastral records are in good order and have been kept up to date.

purchase options at cost prices of 150,000 lei to 300,000 with conventional long-term, low-cost financing).

- No significant rental increases, either through raising public housing rents or relaxation of private rental controls.
- Enlarged scope for divestiture of existing public housing and sale of new units, by widening existing programs and offering purchase options for newly-built public rental housing. A draft divestiture law proposes sale prices of 7,000-8,000 lei per square meter and a prohibition on resale for 5-10 years. Privatization of the older state housing stock is clouded by claims of former owners (and their estates) on units which were previously nationalized.
- Greater—but as yet unspecified—scope for private sector activity. This is not a high government priority. The spurt of activity following the relaxation of restrictions on the private sector is likely to be short-lived rather than developing into a sustained private real estate market unless action is taken quickly to remove the many handicaps that the private sector faces—rent controls, subsidized price competition from the public sector shortages of serviced land, credit, and building materials.

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