Bogdan M. Chiritoiu, MA, MSc
Assistant Professor

Warning

Risky social security funds management

The Ministry of Labour had to deal with hot potatoes, one after another, in the last half year. MMPS has stepped back at each encounter with opposition (trade union especially). Its veiled effort to solve things by confiscating health care money may backfire.

Reach high, settle low

Labour market and welfare reform issues have received the most attention of all the policy initiatives of the government. A large number of issues have come at the forefront of the political debate, and on each count the government has faced a strong flack of criticism, coming from media, trade unions, employers, and opposition parties. It ended up by climbing down, giving in especially to trade union pressure. The influence of the trade unions looks rather inflated, as there are only 4 million legally registered full time employees out of the estimated 8 million Romanians who actually work, and only half of these 4 million are trade union members.

- **The labour code**

Alarm bells have initially rung over the newly created reserve fund aimed to guarantee the payment of wage liabilities. While its creation is part of the EU acquis requirements in the social field, its size was questioned. The government has backed down in front of media criticism and the pressure of employers, and withdrew the draft.

The cabinet has recently approved the draft of the labour code and submitted it for Parliament approval. It preserves the controversial new fund, but ducks the question of its size, by postponing this decision for later legislation.

The labour code has been applauded by trade unions, and they even requested that the government transform its passing in a matter of parliamentary confidence, thus precluding any debate on and amending of the draft.

On the positive side, the draft reduces the number of special labour group employees (i.e. employees that benefit of special retirement provisions) from 1,000,000 to 250,000, back to the pre-1989 situation.

The draft contains a number of controversial provisions however. The critics portrayed it as heavily biased in favour of trade unions, and against the employers, and putting too much social responsibility (i.e. expenditure) on the shoulders of the latter. First of all, even the priority given to wage liabilities over other types of liabilities (e.g. taxes, bills) was criticised.

In addition, the decision to unify the tax treatment of part-time (*conventii civile*) and full-time labour contracts by levying full social contributions on both has aroused fears that it will result either in increased unemployment or in pushing jobs into the black market. What is indeed strange is that even if the part-time employees will pay the full pension contribution, this time will not be counted at all towards the minimum working period that gives the entitlement to the old age pension.

The part-time contracts play an important role in the plans of the government. Over the past twelve years, Romania has seen a marked decline in the number of full – time employees (i.e. contributors to social insurance). Table 1 presents the evolution of the dependency rate (i.e. contribution payers per pensioner). The situation is even worse if we add up the retired farmers – in 2001 there were 6,365,000 pensioners in total, as opposed to 4,505,000 full-time employees. While this trend is correlated with a marked increase in the number of pensioners, it is also true that some of the missing employees have resorted to less taxed part-time contracts. The Ministry of Labour relies on the taxes now to be levied on the part-time employees to help balance the pension fund budget, a major reason of concern, as we shall see later on, when discussing new developments in the pension reform. The problem is that the Pension Fund estimates at 1,200,000 the number of part-time contracts (of which only 100,000 currently pay the voluntary pension contribution). However, the more reliable statistic is the one coming from the Health Fund: the health contribution is mandatory for all part-time contracts, still the Health Fund receives contributions from only 650,000 part-time employees. The gap between expectations and reality will become even larger, as the high social contribution will force a number of part-time contracts to be cancelled.

Table 1. Dependency rate

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Dependency rate (contributors / pensioners)	3,43	2,69	2,17	2,10	1,91	1,75	1,63	1,48	1,32	1,16	1,05	0,98

- **Pension reform**

The pension reform zillion-part soap opera is making a new turn. Last year the revised pillar I (Pay As You Go) has come into force. International donors had found it barely passable. While its design was applauded, the parametric changes introduced were deplored:

- The increase in the retirement age is phased in along 14 years, what makes it rather irrelevant – by the time it took full effect a new parametric evaluation will have to take place;
- In addition, the value of the pension point (decided yearly in the Budget law) is allowed to fluctuate (upwards) too much, what creates a window of opportunity for election bribery by the government.

Now the government is rumoured to have finalised the draft for the next step of the pension reform: the introduction of pillar II (mandatory private insurance). Promised initially for the Fall of 2001, the Law is provided for in this year both in the agreement concluded with the World Bank, and in the one concluded with the European Union.

Actually, pillar II has been introduced through Emergency Ordinance by the out-going Isarescu administration in 2000, but was promptly suspended by the in-coming government of Adrian Nastase. The new draft mainly preserves the provisions of the ordinance. The private pension funds will be supervised by a new regulator, and not by the Insurance Supervisory Commission, as is currently the case. Pension funds will not be guaranteed by the government, but mutual insurance in the industry will be mandatory – much on the model of the current insurance of bank deposits.

However, the big innovation is coupling the 2nd pillar with the 3rd one – voluntary private insurance. The latter will be allowed to start immediately, as opposed to the 2nd pillar, which will become operational only in two years time. The third pillar is practically already in operation, as private life insurance and pension plans. Currently, there is no specific regulation for them however. The importance of the new draft consists in the fact that it will also allow the functioning of voluntary occupational pension schemes, non-existent so far in Romania. Occupational pension schemes consist of pension plans that involve all the employees of a company.

The factors driving the suspension of the previous government ordinance are not altogether clear. Allegations were made concerning need of governing party to have time to develop connections with the soon to be operators in such a large industry. The question marks over bridging the funding gap – the deficit in the PAYG pillar due to channelling contributions in the funded pillar – played a part. There was also the opposition of the trade unions, interested to have access to the management of the pension funds. This access was practically denied in the 2nd pillar as set up by the Isarescu Ordinance, mainly due to the high capital requirement for market access. The new pension draft law preserves this restriction. However, occupational pension schemes (which provide an important role for the trade unions) are allowed in the 3rd pillar. This leaves open a back door for the trade unions towards the high prize of the 2nd pillar. The trade unions will be able to start their occupational schemes at once, and gather enough experience and scale over the two years till the commence of the 2nd pillar. Therefore they will be in advantageous position to lobby for lifting the restrictions for access to the 2nd pillar market by the time this will be operational.

The government has hesitated for a long time over these issues. First of all, in a country traumatised by regular financial crashes, building the credibility of the new pension industry will not be helped by the interference of trade unions. Moreover, the international experience provides a number of examples of occupational pension schemes that went awry, of which Enron is only the most recent In spite of all these doubts, the government appears once again to have succumbed to trade union pressure.

- **Minimum wage**

Pay policy is a new area where the government made substantial concessions to trade unions. The most publicised was the hike of the minimum wage from less than 60 Euro currently, to at least 70 Euro in January 2003, and perhaps as much as 100 Euro in 2004. It is incomprehensible that such rises could be justified on productivity growth. More important, they will have snowball effects in the economy: as much as 2/3 of all employees are paid very close to the minimum wage, and a number of other wages and benefits are tied to the value of the minimum wage.

Apart from the dramatic increase of the minimum wage, the government has also conceded to lift pay restrictions in public companies that are in the black, has promised pay increases above the inflation rates in the public sector, and has breathed new life into the Indexation Commission, that is supposed to make sure the minimum wage keeps pace with the value of a basket of consumer goods.

- **Tax reductions**

The government has recently cancelled a number of tax facilities – e.g. the reduced profit tax for exporters and the VAT exception for tourism and building industries. There is a debate now that these in effect tax hikes should be offset by decreasing labour taxation. The government has agreed with the trade unions that social contributions should be reduced with 5% (out of the current aggregated 57%) of the gross wage. Moreover, this reduction will come mostly from the part supposedly paid by the employee, and only a meagre part from the employer's direct contribution. In addition, the government has also promised to reduce the income tax on lower wages and to increase it on the higher ones.

- **Enlarging the tax base**

A solution envisaged by the government is the enlargement of the tax base. Here comes the replacement of part-time contracts with fully taxed labour contracts. Another measure is the announced elimination on the ceiling on contributions to social insurance (currently the amount on which the social contribution is levied is limited to three times the average wage on the economy). Finally, the government intends to crack down on (legal) tax avoidance: a number of companies reduce their tax exposure by paying employees instead of wages insurance contributions, or dividends.

Eyeing the health treasure trunk

As a consequence of these recent policies on the background of an already looming crises, the Labour Ministry has to deal in the field of social insurance with:

- a large deficit of the public pensions fund;
- the impossibility to advance to the internationally mandated private funded system (2nd pillar) because the mechanisms for covering the funding gap (i.e. loans and bonds) require a lower deficit of the current pension fund;
- a commitment to decreasing social contributions.

The way out considered is redistribution between the social insurance funds. There are three major social insurance funds:

- the pension fund, that collects 35% of gross wages
- the health fund, collecting 14% of gross wages
- the unemployment fund, collecting 6% of gross wages

The pension fund is in chronic deficit, while the other two register surpluses (see table 2 for details). The health fund has especially been targeted by successive governments: in spite of a growing financial crises in the health sector itself, each year the Ministry of Finance has not allowed the National Health Insurance House to spend all the revenue collected. In addition, the surpluses had to be deposit in the Treasury, with below inflation rate interest.

The pension contribution (called CAS – social insurance contribution) actually funds a large number of other benefits, apart from the old age pensions (table 3 presents the breakdown according to the number of beneficiaries):

- maternity benefit
- spa rest and treatment
- medical leave
- labour accidents
- invalidity benefits

For labour accidents a new special insurance fund is to be created, in accordance with the acquis requirements. As the argument goes, at least part of the other benefits could be transferred to the health fund. At a closer look, this proposal seems to be guided more by a Robin Hood logic, than by any rational argument. With the exception of medical leave, the other benefits are non-contributory, and therefore would make more sense to have them funded from the State Budget (ie MMSS) than from the Social Insurance Budget.

Table 2. Chronic deficit of the pension fund (Million ROL)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Revenues	164073	468473	1315121	2811958	3925368	5910161	13164176	23331989	37936470	51016388
Expenditure	155069	404344	1174730	2760680	4090448	6096920	13221909	26539398	39170766	55626915
Pensions	119556	321676	1042464	2461126	3669164	5547645	11663924	21936696	33105143	47068891
General surplus / deficit	9004	64129	140391	51278	-165080	-186759	-57733	-3207409	-1234296	-4610527
General surplus / deficit as % of GDP	0.41	1.06	0.70	1.03	-0.23	-0.17	-0.02	-0.86	-0.22	-0.57

Table 3. Average number of pensioners (000s persons)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Social insurance pensioners (excluding farmers)	2570	3018	3201	3253	3439	3600	3740	3875	4020	4181	4359
For the work done and age limit	1859	2279	2376	2365	2480	2568	2656	2753	2851	2961	3087
For disability	208	222	263	307	374	433	469	493	527	567	609
Successor allowance	503	517	562	581	585	599	615	629	642	653	663
Social insurance pensioners	1007	1016	999	1139	1478	1587	1612	1649	1682	1713	1751

– farmers											
Social benefit[1]	35	31	27	22	20	17	15	13	11	10	8
Pensioners IOVR (war invalids, orphans and widows pensioners)	67	66	65	62	58	54	50	46	42	37	35

A unique social insurance fund?

The alternative chosen, at least by the Labour Secretary Sirbu, is to create a unique social insurance fund, by consolidating the three existing ones. This decision is part of the protocol of understanding signed with the trade unions. It is however telling that the government was represented in this negotiations by the Labour and Finance Secretaries, and is not clear how much the Health Secretary was consulted on such a crucial matter.

With World Bank blessing, the government has already unified the inspection function for the three funds. It has further agreed with IMF that the collection for the three funds will be unified. This would have clear administrative advantages, both for the administration and for the employers.

The idea of unifying the funds (i.e. money) presents a number of disadvantages. First of all, it practically bails out the reckless management of the pension system, by using health tax money to fund irresponsible pension pledges. It also blurs the distinction between the social contributions paid by the tax-payers and the services they receive, reducing therefore the transparency and accountability. Most important, it is likely to starve of resources the health sector that already faces a serious financial crises, and which is anyway under-funded by both EU and regional standards.

There is another factor worth taking into account: the health fund records a much better contribution collection rate than the pension fund. There are a number of reasons that could explain this situation:

- First of all, back-payments of taxes are not allowed at the health fund, as opposed to the situation of the pension fund, where they are an established way of paying off the political clientele.
- Second, the pension contribution is much larger than the health contribution (35% versus 14%) what might deter contributions
- Third, the threat of denying access to benefits for non-payment is more credible in the case of healthcare than of the distant pension
- Fourth, there are trade union representatives in the boards of the regional health funds, and they are said to help persuade the managers to pay the contributions
- Finally, there is a difference in the legal treatment of the employee contribution and of the employer contribution: the employer non-transferring the employee contribution is a penal matter, while non-paying its own contribution could lead only to a fine. Therefore the collection rate will be improved when the part of the contribution paid

[1] Support allowance of pension type paid from social insurance funds.

directly by the employee is larger, as is the case of health tax - 50%, compared with 33% in the case of the pension contribution

It is conceivable that the common collection of social contributions will not enjoy the advantages present in the case of the current health contribution, and therefore the effect of the unification on the collection rate is doubtful.

Conclusion

- The Ministry of Labour has got the habit of throwing itself in a large number of policies, and capitulating when it runs into opposition. This approach has led to a serious risk of derailing pension reform, undermining the health sector, and now presents a threat to wage stability.

- The last fade of merging the social insurance funds should be abandoned. The merger of audit and inspection functions is a welcome development. The merger of collection has a lot going for it. It will reduce the administration cost and will be a considerable simplification for employers. It is however less certain the impact it will have on the collection rate.

- The prospect for a positive outcome will be increased if some of the advantages of the current health tax will be preserved – e.g. the absence of back-payments, and a high component paid by the employee.

- In any case, the amalgamation of funding for the social insurance funds would practically redistribute money form the health fund to the pension one, avoiding a head on solution for the problems of the pension system, and bankrupting the healthcare system instead.