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Unfinished Business: The Romanian Welfare Reform

The Romanian welfare system is in crisis. The value of the benefits has continuously decreased in real value. The economic restructuring induced poverty and the misalignment of work incentives have led the number of beneficiaries to skyrocket. Hefty surpluses at the start of the decade have thus turned into deficits, due to the shortsightedness of the post-communist governments. And the demographic trend is working against the welfare system.

The current government made commendable efforts to redress the situation. The public pensions system has been reformed, and the different income support benefits have been integrated in the minimum income guarantee. However, many of the reforms measures remain unfinished. Moreover, the long awaited funded pension scheme is still on the drawing board, and the flagship minimum income guarantee will prove a formidable challenge to the local governments that have to implement it.

I. A rising challenge

Poverty has increased in Romania over the transition period, mainly as a result of the negative economic evolution. Almost half of the population now lives below the poverty line – see Tab. 1. International comparisons, employing purchasing power parity equivalents, show that Romania has one of highest poverty rates in the region, surpassed only by Moldova, Albania and Russia (Tab. 2).

Tab. 1. Poverty in Romania, 1995 - 2000

	Poverty rate	Extreme poverty rate
1995	25.3	8.0
1996	19.9	5.1
1997	30.1	9.5
1998	33.8	11.7
1999	41.2	16.6
2000*	44.0	-

Source: Tesliuc, Pop, Tesliuc, 2001

Tab. 2: The Poverty in Central and Eastern Europe, 1995 - 1999

	Year	Poverty rate (% of population)	
		2 USD PPP*/day	4 USD PPP/day
Moldova	1999	55.4	84.6

Russia	1998	18.8	50.3
Albania	1996	11.5	58.6
Romania	**1998**	**6.8**	**44.5**
Macedonia	1996	6.7	43.9
Latvia	1998	6.6	34.8
Bulgaria	1995	3.1	18.2
Lithuania	1999	3.1	22.5
Ukraine	1999	3.0	29.4
Slovakia	1997	2.6	8.6
Estonia	1998	2.1	19.3
Hungary	1997	1.3	15.4
Poland	1998	1.2	18.4
Belarus	1999	1.0	10.4
Croatia	1998	0.2	4.0
Czech Republic	1996	0.0	0.8
Slovenia	1997/98	0.0	0.7

Source: World Bank, 2000
Note: The poverty estimates use thresholds in USD/day/adult at 1996 purchasing power parity equivalent.

The rise of poverty has been augmented by the decreasing public support the needy received. Tab. 3 shows that the relative value of social benefits has decreased substantially. It is interesting to notice however that, against common wisdom, pensioners have suffered relatively less than other categories: compared with the average wage, the average value of the public pension has decreased with only a quarter, compared with drops of up to two thirds for other benefits.

Tab. 3. Social benefits as percentage of average wage

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
The average public social insurance pension	46.4	44.7	45.1	43.6	45.2	42.6	40.8	38.6	40.3	37.2	35.9	34.3
Child allowance	10.5	9.7	7.2	5.4	4.9	4.2	4.3	3.9	7.4	6.2	4.3	3.2
Supplementary allowance for the 2nd child*	-	-	-	-	-	-	-	-	13.7	10.1	7.0	5.5
Income support		-	-	-	-	-	21.3	14.0	15.6	13.2	10.6	7.7
Support allowance (post unemployment benefit)		-	-	20.0	16.1	14.4	18.6	15.7	15.4	14.7	16.8	12.9
Integration allowance	-	-	-	-	-	24.7	20.1	17.0	18.8	17.9	21.9	17.4

*Since 1997, a supplementary allowance for families with 2 or more children was introduced
Source: ICCV

Tab. 4 offers an insight in the causes of the decreased resources available for social protection. The number of those fully employed has almost halved over the transition period, from over eight million, to four and a half. Full time employees represent now only one third of the working age population. This drop in the resources available for the social protection system has been mirrored by a proportionate increase in the demand for social benefits. I shall come back to This point will be detailed further below.

Tab. 4. Decreasing rate of contributors

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Fully employed (‘000)	8,156	7,574	6,888	6,672	6,438	6,160	5,939	5,597	5,200	4,737	4,458	4,505
Fully employed / population aged 15 – 60 (%)	57.82	53.53	49.52	47.77	45.90	43.76	42.12	39.69	36.90	33.75	31.66	31.99*

*estimate using the 2000 population data
Source: INSSE

The demographic trend works also against the welfare system (Tab. 5). Romanian population is ageing, and the country records a negative overall population growth. This means that, unless there is dramatic action, the pressure on the resources of the system will only grow.

Tab. 5. Ageing population

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Population 15-60 (‘000)	14,105	14,148	13,908	13,965	14,026	14,075	14,098	14,101	14,094	14,035	14,081
Population over 60 (‘000)	3,632	3,708	3,778	3,842	3,901	3,960	4,009	4,068	4,130	4,148	4,199
Population over 60 / population aged 15-60 (%)	25.76	26.21	27.16	27.51	27.81	28.14	28.44	28.85	29.30	29.55	29.82

Source: INSSE

The Romanian government rose to these challenges by planning an overhaul of the welfare system. The Isarescu administration initiated (but failed to see through) a large reform of the pension system. The new government of Adrian Nastase has followed suit with a tidying up of the income support system, by introducing the minimum income guarantee and revising the unemployment benefit.

II. Muddling through the pension reform

Romania has entered the 1990s with a healthy situation of pension funding. However, the political unsustainability of the PAYG scheme and the demographic evolution have bankrupted the system. The newly implemented law on pension reform 19 / 2000 has improved the incentives by encouraging higher contributions over a longer period. These improvements do not go far enough. The demographic trend and the motivational problem built-in in a PAYG system require the introduction of a funded scheme. This reform has the backing of the World Bank, had been under consideration in Romania since 1993, and a bill was passed in the final days of the previous administration. The Nastase cabinet, however, is not fully engaged in implementing this reform. Its plans are still sketchy, the envisaged size of funded sector is small, and the conditions set for its implementation are doubtful at best.

1. The emergence of the crisis

Similar to all the other former socialist countries, Romanian pension system was a PAYG (Pay As You Go) system, where the pension of today pensioners is paid from the wage-related contributions of today employees, and the quantum of the pension is somehow income related (with minimum contribution periods), but not directly related to the overall contribution. The key variable for such a system is the dependency ratio: the number of employees (contributors) per pensioner.

Romania has started the transition in the 1990s with a healthy dependency rate of 3.42. This situation quickly changed (see Tab. 6). The demographics worked against the pension system: the population decreased, due to negative natural growth and emigration (see Tab. 7). The main reason behind the spiraling dependency rate has been premature retirement. Taking advantage of the generous provisions of labor laws that allowed for normal retirement as early as 50 for women and 55 for men, and the upgrade of a number of professional categories into the higher risk ones, allowing for full pension at early retirement, scores of Romanian older employees, facing the challenges of the transition economy, chose the relative security of early retirement.

Tab. 6. The dynamic of the 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	1.00

Source: INSSE

The number of pensioners has quickly risen (see Tab. 3), and, if agriculture employees are also included, by 1999 has overtaken the number of employees paying contribution. The rise in pension liabilities has been coupled with a shrinking contribution base due to the transition output contraction. These two factors have pushed the social insurance budget separated from the central government budget since 1992, from a strong positive cash flow, into the red by 1995 (see Tab. 8).

Tab. 7. Increasing number of pensioners

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Average number of pensioners ('000)	2,380	2,816	2,996	3,174	3,358	3,518	3,651	3,782	3,923	4,074	4,246	4,477
Pensioners/ population aged 15 –	16.87	19.90	21.57	22.73	23.94	25.00	25.90	26.82	27.83	29.02	30.15	31.79*

60 (%)

* estimate using the 2000 population data

Source: INSSE

Tab. 8. Financial situation of the Pension Fund

	Revenue (% of GNP)	Deficit (% GNP)	Revenue (bil. ROL 1990)	Expenditure (bil. ROL 1990)
1991	7.44	0.41	607.23	573.90
1992	7.77	1.06	558.50	482.05
1993	6.59	0.70	440.28	393.28
1994	5.65	0.10	397.62	390.37
1995	5.44	-0.23	419.67	437.32
1996	5.43	-0.17	455.21	469.59
1997	5.26	-0.02	397.99	399.73
1998	6.81	-1.01	438.16	503.42
1999	7.35	-0.25	492.56	508.75

Source: INSSE

The government has reacted by increasing the contribution rate. Since 1990, the old age pension contribution rate has more than doubled (from 17% to 35%). The Romanian main pension contribution rate is one of the highest among transition economies (see Tab. 11). However, this has failed to alleviate the problem, because the increased taxation has pushed even more people out of the legal economy, mostly into the informal one.

The only compensation strategy available to the government, faced with a growing number of pensioners and lack of financial resources, has been the decline in the value of pensions. Tabs 9 and 10 present the absolute impoverishment of pensioners (the decrease in the real value of average pension) and their relative impoverishment (the decline in value of the average pension as a proportion of the average wage).

Tab. 9. Absolute impoverishment

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Average real pension (%)	100.0	77.5	63.7	56.5	55.3	61.2	62.8	49.7	48.5	50.44	46.90	47.36

Source: INSSE

Tab. 10. Relative impoverishment

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Replacement rate (average pension / average wage (%)	44.6	45.0	43.6	45.2	43.2	40.7	38.6	40.3	39.1	35.0	38.9	42.3

Source: INSSE

2. Pension reform

Discussions about pension reform go back as far as 1992, when the first White Paper has been published. However the first major review of the system was the law 19 / 2000 that came into force on April 1st 2001. The law reforms the state pension – the so called pillar one of the new pension system envisaged. This change was supposed to be supplemented by the pillar two – compulsory pension contribution managed by private pension funds and pillar three – optional private pension. However, the second and third pillar run into opposition, among others form the trade unions, who wanted a stronger say in the work of the funded scheme. This delayed the transit through parliament. Finally, the reform has been enacted through an emergency government ordinance OUG 230 / 2000 in the latest days of the outgoing Isarescu government. The ordinance has been quickly annulled in the first meeting of the incoming Nastase government.

The pension law phased in an increase in the retirement age with five years (to 60 for women and 65 for men), and changed the method for calculating the pension from one based on the income in the latest years of activity, to one that takes into account the contribution over the whole working life – with an yearly ceiling of three times the contribution for the average wage. These changes should assure that people stay longer in the labor force. In addition, it becomes in the interest of employees to demand to their employers to fully report their wage, therefore bringing into open some of the informal economy.

3. Limitations of the reform

However, in any form the law does not guarantee a good return on the contribution. It only provides that somebody who had a higher contribution will have a proportionally higher pension, but not that it will be a good pension. This is where the private management of pension funds would prove useful. A funded scheme would allow for a higher return than the meager one provided by the state pension fund. In addition, a funded scheme would alleviate the political dependence of the PAYG system (the value of a pension point is decided annually by the government, and is therefore completely unpredicTab.), its major motivational shortcoming. For a comparison with other CEE countries, see Tab. 11.

Tab. 11. Reform laggard: comparison between Romanian pension reform and selected CEE countries

Country	Reform	Date of introduction	Retirement age	Contribution level
Croatia	Three pillar system	1999	65 (both men and women)	25.4%
Latvia	Virtual capitalization	1995	60 (both men and women)	37%
Poland	Three pillar system	1999	65 men / 60 women	19.52%*
Hungary	Three pillar system	1997	62 (both men and women)	31%
Romania	Reformed PAYG	2001	65 men / 60 women	35%*

* Old age pension contribution only

4. Trends

The demographic trend will continue to work against the pension system, with the working age population continuing to shrink as the Romanian population grows older. The unknown quantity here is the number of contribution paying employees. On one hand, the economy has registered a good growth rate in 2001, but this performance is unlikely to be repeated in 2002. This has led only to a very modest increase in the number of jobs, probably because an increased output have been offset by the under-utilized production facilities through increasing the productivity of existing employees. In addition, the expected economic restructuring process might lead to more unemployment. The unemployment rate has already recorded a slight increase towards the end of 2001. On the other hand, the crucial element will be whether tax evasion will be reduced: employees in the informal economy joining the formal one, and employers reporting the full earnings of their employees.

The pension law that has come into force provides the right incentives for helping the survival of the pension system. However, the system is going to face a mounting pressure from the ageing population, and faces the uncertainty over the evolution of the number of contribution paying employees – dependent on the overall evolution of the economy, but also on the industrial restructuring process, and especially on coming into light of the informal economy.

The increased efficiency, and the supplementary contributions brought by a privately managed funded system will prove helpful in mitigating these risks. The government should devise a replacement along the line of the emergency ordinance of the previous administration.

5. Challenges for the reformed system

- ***Doubtful results***. The new law still has to make its effects felt. Against government predictions, the initial data showed that the deficit of the social insurance budget did not diminish. The best explanation for this trend is the high number of individuals who quickly applied for retirement under the provisions of the old law, before the new legislation came into force. This effect can be expected to gradually fade away, but the actual impact of the new legislation is still not clear.
- ***Public hostility***. A challenge faced by the new pension legislation is the ignorance and skepticism of public opinion. Opinion polls (SAR's own survey presented in a previous monthly issue of EWR) have consistently shown that a majority of the population do not have enough information about the new pensions system, but expect to be negatively influenced by it.
- ***New labor contracts?*** The Government's intention to abolish the difference between full-time working contracts and freelance contracts is consistent with its overall approach to the reform of the pension system, but it also raises some concerns. In this context, it should be highlighted that, over the last two years, the difference in the tax regime of these two types of labor contracts has diminished. Income tax, as well as employee health contributions, are paid on both of them. Freelancers represent about one quarter of employees[1]. If as a result of abolishing freelance contracts, these jobs move to the underground economy, the loss of revenue for the state will be considerable.

6. Introduction of the second pillar

The PAYG system is supposed to be supplemented by the second pillar (compulsory pension contribution managed by private pension funds) and the third pillar (optional private pension).

[1] There are currently approximately 1.5 million freelance contracts and 4.5 million full time contracts.

The World Bank supports the three-pillar structure of the pension system and the other CEE countries also aim to introduce it. They hope the advantages will result in better management of pension funds, with increased returns, that in turn would encourage people to contribute and stay longer in the labor force. In addition, the large sums available would stimulate the capital market, especially by increasing the liquidity, and thus improving the efficiency of the economy.

The reform was debated in the previous Parliament. However, the second and third pillar run into opposition, amongst others form the trade unions, who wanted a stronger say in the work of the funded scheme. As I mentioned earlier, the reform was finally passed by an emergency government ordinance (OUG 230/2000) in the last days of the outgoing Isarescu government, but the ordinance was quickly taken down in the first meeting of the incoming Nastase government.

Financing the transition period

The new government has let it be known that the new draft of the second pillar law would become public in fall of 2001. It failed to live up to this promise. The reform is however part of the government program and is scheduled to be implemented by the end of current parliament (2004). There is one major problem for the introduction of the funded system however. It concerns the transition period between the introduction of the new system, when the working population starts to contribute for their pension account, and the maturity of the system, when these people start receiving their pensions. During this transition period, the contribution will be capitalized, and can no longer be used for paying the outstanding pensions to the current generation of pensioners.

There are two solutions envisaged for this problem. First of all, the size of the funded scheme will be low, and will grow only gradually. It is planned that it will initially represent only 2% of the wage, and it will later increase to 8%. In addition, the funded scheme will be introduced only when the budget of the pension fund is balanced. The government estimates that this should happen by 2004-2005, based on the expectation of improved economic activity and increased number of employees, coupled with improved collection of the contributions, increased retiring age, and only a modest increase in the real value of pensions.

The government's plan treats the funded scheme as a luxury: it will be implemented when it is not needed (i.e. when the budget is already balanced), and it will be small anyway. The danger with this approach is that the new scheme may have little impact. Moreover, the economic expectations upon which the timing of reforms depends look shaky. If anything, the budget of the pension fund is going to be under serious pressure over the next few years: the government has promised the indexation of pensions according to the rate of inflation, and in December this year is supposed to start the three year process of 're-correlation', by the end of which all pensioners with comparable professional record will receive the same pension.[2] The moral case for this is solid, but consecutive Romanian governments have failed to find the means to achieve the 're-correlation'. The Isarescu Cabinet even had to backtrack on its promise in an electoral year.

[2] Until the implementation of the new pension law (19/2000), the quantum of the pension used to be determined according to the nominal wage. Due to the high inflation of the last 11 years, this algorithm led to paradoxical situations where people with the same profession received very different pensions, according to the year when they retired. This system was very detrimental to those who retired before 1989, or soon afterwards.

Beyond the fundamental questions concerning the size of the private scheme and the timing of its introduction, there are technical matters that have to be solved first.

The size of pension funds

The size of the funds is a matter of contention. Here the government faces a trade-off. Large pension funds (in terms of capital requirements and minimum number of registered people) would be more credible with the population, whose confidence is pretty low after the series of debacles, of which FNI is still fresh in memory. However, establishing high barriers for market entry would deter competition, thus reducing returns. Moreover, it means that the industry would be dominated by foreign players, thus antagonizing the domestic allies of the government who are interested in entering this lucrative business, as is especially the case with the trade unions. Their opposition on similar grounds helped derail the adoption of the legislation by the previous administration.

Regulation

Supervision will be crucial for the credibility of the scheme. After successive fiascos in the financial sector, entrusting one’s savings (even if compulsory) to a private fund for 20 or 30 years, with the expectation that eventually one will receive a pension, requires a leap of faith. The stakes are very high, and any mistakes by the regulator could have dire consequences for the state budget, which will be the ultimate guarantor. From the institutional point of view, there are three possible options. One possibility is for the insurance watchdog to also take over the supervision of the pension funds. Another option would be to establish a new specific regulator. Finally, one could also take into account the creation of a super-watchdog that would cover the whole financial sector (banking included).

From the three alternatives, the first one is probably the most feasible. Since most pension funds will be connected to insurance (especially life insurance) companies, the Commission for Insurance Supervision is well placed to also supervise pension funds. The Commission has the advantage that it acquired experience in dealing with the insurance companies. Setting up a new institution would be cumbersome, even more so if it has to cover the whole financial sector, wresting control of the banking sector from the Central Bank.

Investment policy

The draft bill is expected to limit the share of funds that can be invested abroad by pension funds, to 10%. The desire of the government to have pension funds help in reviving Romania’s capital markets, rather than worsen the balance of payments, is understandable. There are good reasons to be cautious however. The domestic capital market is very thin, and it does not have the capacity to absorb large funds. This is less of a problem over the short term, when the volume of the private pension contributions is capped to 2% of the wage. More significant is the argument that investing abroad is essential for risk mitigation. Actually, this is also the only way to deal with the demographic trend – the ageing population. Finally, a ceiling of 10% for investments abroad may be incompatible with the accession to the European Union. Such a ceiling infringes the free movement of capital, one of the cornerstones of the internal market. Sooner or later, depending upon the negotiations with the EU, this limit will have to be relaxed or removed altogether. It is worth paying attention to the pressure being now put on Poland on the same issue.

The National Pensions House

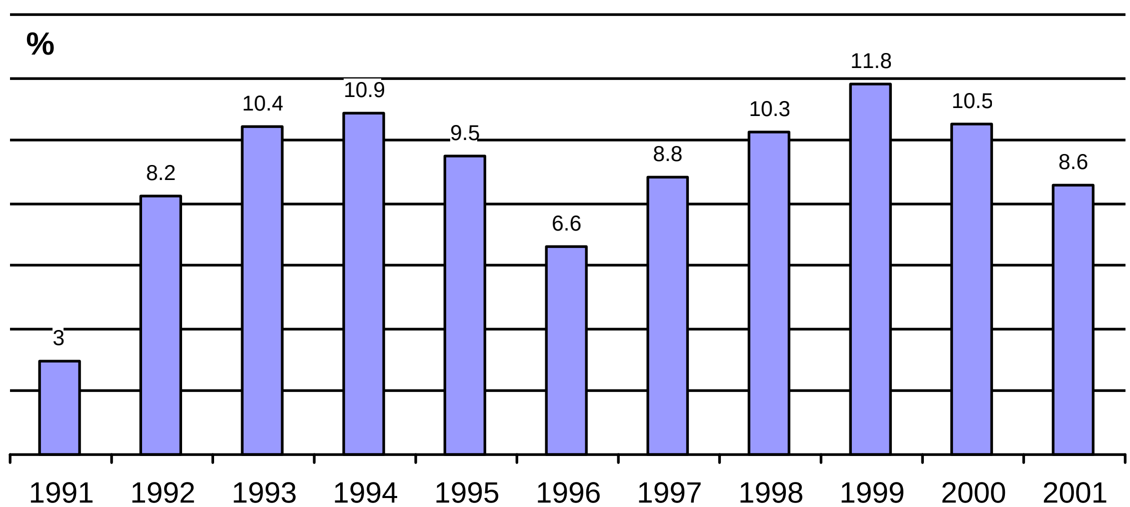
The introduction of the funded scheme will put additional pressure on the National Pension House, the government agency that manages the current public pension system. The National Pension House will continue to collect all the pension contributions. It will be its task to allocate individual contributions to the pension fund of choice. This requires a sophisticated infrastructure. The difficulties already encountered in the public pension system suggest that the current infrastructure is not that sophisticated yet, and its development will require years of preparations.

The reform of the public pension scheme has reached its limits. Policy mistakes in the early 1990s have put the whole system on a very shaky footing, and the demographic trend is making things even more difficult. The solution is to introduce a large funded component in the pension system. The challenge facing the government remains formidable both in political and technical terms.

III. Unemployment policy

The good news for 2001 regarding unemployment is that the rate is down below 8% by the end of the year, the lowest since 1996 and below the initial official forecast (9.9%) – see figure 1. The unemployment was going constantly down every month from the beginning of 2001 until October 2001 when, with 742,360 unemployed people (7.7 %) it started to grow again. The current rate is however under the target set by the Government in its Economic Development Program and also in the Social Pact agreed with the trade unions.

Fig. 1. Unemployment rate, 1991-2001



1. Compensatory payments

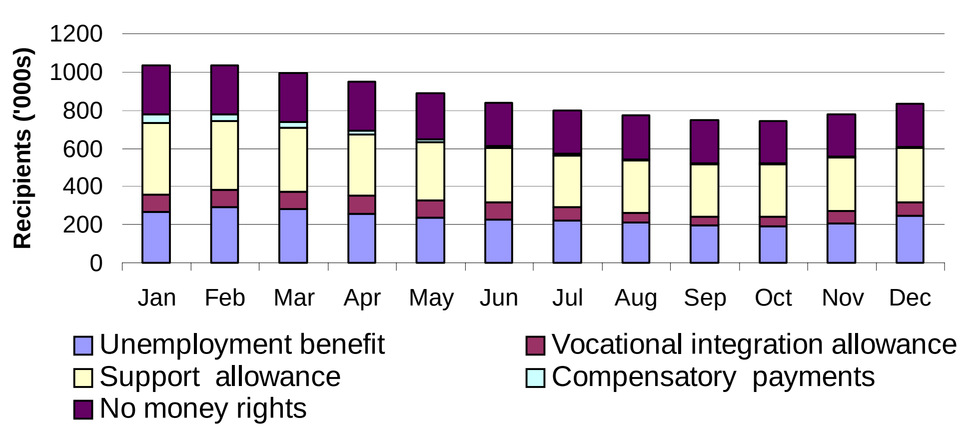
Just in 1999 the unemployment rate peaked above 11%. It was the time when the compensatory payment system was spread out and was seen almost as the only solution for avoiding social conflicts. During 2001 the number of people receiving compensatory payment decreased to 5,893 in November. The decline is important. 45,035 people received such payments at the beginning of the year but in the first part of 2001 almost all those who had received such payments in 1999 and 2000 have lost their entitlement.

The current government decided to restrict the use of compensatory payments to those provided for by the OUG 98/1999, and employ them as a last resort measure only. This means that the compensatory payments will be used only in regular employment restricting situations. If the government does not restate the severance payments for those dismissed from state-owned companies under restructuring – a very dangerous, yet very popular practice between 1997-1999 – the next months could be the last for this very expensive unemployment fighting policy.

2002 will bring new challenges. The PSAL program (convened with the World Bank) will require collective redundancy procedures in Spring 2002 and the Government promised a re-evaluation of the effects of PSAL on the labor market.

2. The structure of unemployment benefits

Fig. 2. Evolution of unemployment by tipe of payment, 2001



The Unemployment Fund supports also three other type of payments: the regular unemployment benefit, the support allowance (received after the expiration of the entitlement to the unemployment benefit) and the vocational integration allowance (employment subsidy). The payment structure is presented in Fig. 2. A specificity of the unemployment structure is the fact that the number of the support allowance receivers was every month higher than the number of the unemployment benefit receivers. Support allowance is a passive measure on the labor market, since it is not conditioned by any other active measure (as job seeking or doing temporary work activities).

3. New jobs

If the decreasing number of the unemployed people is still bigger than the number of new jobs appearing on the market, it means that an important part of the people who are no longer registered in the unemployment statistics are part of the black market economy or are becoming part of the unofficial unemployment group.

The employment statistics include persons with labor contracts of determined or undetermined duration, who are in the evidence of economic and social units at the end of the reference period. The number of employees is grouped by CANE activities according to the main activity of the units.

The National Agency of Employment, the main institution trying to find job opportunities for the unemployed, reported by the end of the year that 470,644 people had new labor contracts in 2001. Does that mean new jobs on the market? The total number of employees was at 4,507,000 by the same date, with just 93,000 more then at the beginning of 2001. Even in September when it was registered the highest employment (4,545,000) the difference was no bigger then 130,000. So, many of the "new labor contracts" are for old working places which are becoming free because of retirements, firing etc.

It follows that the decrease of the unemployment rate is not sustained by the growth of the number of full-time employees in the economy. Temporary jobs were probably the main solution for increasing the labor force. They provide less social protection however, as the pension contribution is lower or null. There is also the risk that some people passed from the monitored unemployment to the unofficial unemployment or/and black market.

4. Challenges for 2002

From this perspective, 2002 starts with bad news: there is a strong restructuring process in the defense industry, the PSAL agreement with the Word Bank will bring some new unemployed people on the market despite the protection measures which are part of the program. Due to the temptation of the minimum income guarantee the statistics will include some people who were lost during the last years.[3] To qualify for the income guarantee it is necessary to be registered as job seeker. The spring of 2002 will therefore bring an increase in the recorded unemployed rate. There are two institutional solutions for these developments.

- **The National Action Plan in Employment**, implemented by the National Agency for Employment and Professional Training, will focus on active measures for the labor market. Instead of only 2 or 3 percent out of the unemployment fund, as the active measures have been allotted so far, the percentage will increase to up to 10 percent. At the same time, taking into account the inefficient use of these funds due to an extremely large diversity of actions,

[3] The income support will fill in 2002 the gap between the guaranteed minimum income and the actual income of the family, other social benefits including unemployment payments or allowance support

and soaring implementation costs, the main directions will be the employment of youth and of the jobless, simplifying also the entrepreneurs' access to the funds.

- **The new law of employment benefits** will bring important changes on the labor market regulation. The unemployment benefit and the compensation payments will be paid gradually and according to the contribution to the unemployment fund (ie according to the number of service years and the last salary), so as to preserve a purchasing power of at least 60 percent of the last salary received. On the other hand, starting with 2002, the other benefits (supplementary allowance and the employment subsidy) will be integrated with the minimum income, with the aim of prodding the unemployed into joining the labor market.

In the following months the (recorded) unemployment rate will probably grow. Even if the rate will exceed again 10%, this is no seroius threat for the Unemployment Fund. By contrast, the unofficial unemployment and the black labour market should be a major concern for the government.

IV. Poverty Alleviation: Minimum Income Guarantee

The poverty has steadily increased during the transition period; both the poverty rate and the harder extreme poverty rate doubled since 1995 (Tab. 1). Romania is also a laggard in regional comparison tables, displaying the fourth worst poverty rate in Central and Eastern Europe (Tab. 2).

1. Sources of poverty

Tab. 3 shows the breakdown of poverty in the Romanian population. Against the common wisdom, poverty is most prevalent not among pensioners, but among young families with many children, the unemployed and even self-employed people (Tab. 12). Over 80% of the families with 4 or more children live in poverty (Tab. 13). Single parent families are also prone to living in poverty (Tab. 14).

Tab. 12. Poverty rate function of the occupation of the head of household

	Poverty rate
Employee	29.7
Retired	25.6
Farmer	57.4
Private enterpriser	10.1
Self employed	53.9
Unemployed	59.8

Source: Tesliuc, Pop, Tesliuc, 2001.

Tab. 13. Poverty rate function of the age and number of children

	1995	1998
1. Poverty rate function of number of children:		
- no children	16.4	23.5

- 1 child	24.6	35.0
- 2 children	30.1	43.6
- 3 children	52.8	64.6
- 4 children or more	71.7	83.6
2. Poverty rate function of age:		
- under 7 years	30.2	37.7
- 7 - 15 years	37.1	48.7
- 16 - 25 years	34.3	45.5
- 26 - 35 years	21.7	31.0
- 36 - 45 years	26.0	36.1
- 46 - 55 years	23.7	32.3
- 56 - 65 years	14.5	21.0
- over 65 years	9.7	11.4

Source: Tesliuc, Pop, Tesliuc, 2001.

Tab. 14. Poverty rate in single parent families (1994)

	Poverty rate
Childless single	17.9
Single parent family with 1 child	51.8
Single parent family with 2 children	76.0

Source: C. Zamfir (ed.), 1995.

Poverty also correlates strongly with low education attainment. A household whose head did not attend the secondary school is 7 times more likely to live below poverty line, than a household headed by a university graduate (see Tab. 15).

Tab. 15. Poverty rate function of the educational level of the household head

	Poverty rate
No schooling/primary school	42.00
Secondary school	41.00
Vocational training	40.00
High school	22.00
College	19.00
University	6.00

Source: Tesliuc, Pop, Tesliuc, 2001.

2. Poverty alleviation

The Romanian government has employed a wide array of instruments in fighting poverty. Most of social expenditure is now accounted for by the employment related contributory benefits, the most important being healthcare, pensions, and the unemployment benefit. In addition, access to education services, an important poverty prevention tool, is free at point of delivery.

In what concerns the non-contributory benefits, there has been a shift from universal benefits to means-testing. The only large universal benefit existent is the child allowance. The means-tested income support was introduced in 1995. During the transition years the value of social benefits has decreased dramatically in both real and relative terms (Tab. 3).

3. Minimum income guarantee

The minimum income guarantee has been one of the key campaign pledges of the new administration of Adrian Nastase. The Parliament has swiftly enacted it through the Law 416 / 18 July 2001. The income support will from 2002 bridge the gap between the guaranteed minimum and the actual income of the family, other social benefits included. There is a supplementary heating allowance for income support recipients, and the universal child allowance is substantially increased.

The minimum income guarantee integrates a number of social benefits:

- income support, burial support and emergency relief, funded from the local budget.
- child allowance, and the allowance for the wives of conscripts, funded from central budget.

The income support will continue to be provided by the local government, but overall 80% of funds are expected to come from the central government, through defined destination grants. Apart from cash transfers, the income support could include goods or services.

4. Poverty-trap

The problem commonly associated with means-tested benefits is the disincentive to work. Since any increase in income is offset by the decrease in the amount of the social benefit, the marginal utility of labor is very low. The result is the so-called ‘poverty trap’: people do not find worthwhile to take the pain of a regular job, and therefore do not acquire the experience necessary for advancing to better paying positions.

Field work funded by the World Bank had found little support for this theory in Romania. If true, this is a refreshing conclusion: due to its low administrative capacity, the Romanian authorities are hardly able to verify the income statements of the applicants for social benefits. As a result, the most probable effect in Romania would be to drive the recipients of social assistance towards the black market, rather than idleness.

However, the law includes safeguards for this situation. The bodily able recipients are required to perform up to 72 hours per month community work, and those legally employed receive a 15% higher income support.

5. Implementation problems

The Achilles’ heel of Romanian income support has been its reliance on local administration. Fig. 9 and 10 paint a dramatic picture of the ability of the local government to implement means-tested benefits. In 1995 the distribution was dealt with by the central government. Since 1996 it was taken over by the local administration. Facing such a big administrative and financial challenge, the local government failed to a large extent to implement the measure properly. In 2000 the number of families receiving income support represented only 6% of the number of 1995 – see Fig. 9 and 10.

Fig. 9. The number of families receiving income support (end of year, compared with 1995)

Year	1996	1997	1998	1999	2000
%	49	26	22	15	6

Source: MMSS

Fig. 10. The dynamic of the real expenditure for social benefits (1995 = 100%)

Year	1996	1997	1998	1999	2000
%	144.2	47.6	30	14.8	-

Note: The 1995 expenditure covered only the last 3 months of the year.

Source: MMSS

In 1994 the estimated number of households qualifying for income support was estimated at 659,000, or about 12% of the population. By 1998 only 50,000 households, including 0.5% of the population, were actually receiving income support.

The minimum income guarantee policy could have the same fate. The Ministry of Welfare (MMSS) estimates that those covered by it will amount to 600,000 – 750,000 a comparable number to those entitled to income support in 1995. Under a comparable administrative and budgetary burden local administration might crack again.

By 2000, most of local authorities, especially in rural areas, had practically stopped distributing the income support. Under the present provisions of the law, a large share of beneficiaries of the minimum income guarantee will come from rural areas (e.g. pensioners from the former socialist farming system). This will create a huge pressure on the local government from rural communities, which are in many cases losers from the financial de-centralization reform introduced by the previous government.

6. Financial feasibility

In 1994 income support covered 87% of the extreme poverty threshold, and 58% of the poverty one. By 1998 its real value has eroded to only 48% of the extreme poverty threshold, respective 32% of the poverty one.

In 1997, income support amounted to only 0.05% of GDP. Now the government expects the minimum income guarantee to raise this amount to 0.4% of GDP, an 8 fold increase.

7. Conclusions

- The minimum income guarantee policy confirms the Romanian government's orientation towards means testing, and away from universal benefits. This option is consistent with the dire financial situation of the country.
- The minimum income guarantee includes measures to mitigate the disincentive to work that is associated with means-testing.
- The minimum income guarantee is part of a complex approach to poverty alleviation. It combines cash benefits with in-kind provisions (e.g. school allowance for pupils), and special measures for high risk social groups (e.g. Roma). This approach should be furthered by developing social assistance programs, as an alternative to cash benefits.
- The government is right in identifying the link between children and poverty. The substantial raise in child allowance is welcome from this perspective.
- The Romanian welfare support system is now well targeted to reach the poor, at least in theory. Its main problem continues to be the lack of resources.
- Abolish the child allowance as a universal benefit, and instead transform it in a means-tested aid, would be consistent with the recent reforms. Large sums of money are now spent on families that are relativly well-off, where they make an irrelevant addition to the household's income.
- Another option is to take into account, when establishing the minimum income guarantee, the difference in the cost of living between rural and urban areas, and employ different thresholds. This would lead to an equalization of the real – not nominal – value of aid and in the same time ease the burden on the local authorities from rural communities.
- Based on the experience accumulated since 1995, if the central government will fail to provide the resources for income support, local administration will unable to cope with the burden, and the whole policy will become an empty promise that will foster frustration. Should the situation of public finances worsen, the government would be better advised to narrow down the scope of the policy, from over 10% of population at present, to a more manageable number.

Romania has made some progress towards the rationalization of the welfare system. The incentive structure of the public pension system has been improved, the wasteful system of large compensatory payments for collective redundancies took a step back, and the minimum income guarantee has integrated the different income support measures into one single scheme. Challenges remain however. Income support might prove to be a burden hard to bear for the overstretched local governments. The most daunting, yet most promising, task remains however the introduction of private pension funds.