

# SOCIAL

## STRIVING TO DELIVER

### **The minimum income guarantee policy is put at risk by the low capacity of the administration**

The flagship initiative of the social democratic government of Adrian Nastase, the minimum income guarantee policy, is meant to tidy up the Romanian welfare support system. Moreover, the law introduces safeguard measures to mitigate the disincentive to work commonly associated with means-tested benefits. The financial feasibility of the scheme, aimed at covering more than 10% of the population, is however in doubt. Should the central government fail to provide adequate funding, the initiative will prove again an empty promise of the national government thrown on the shoulders of an overburdened local administration.

### **Poverty in Romania**

The poverty rate has substantially increased over the transition period. Fig.1 shows that both poverty rate and the extreme poverty rate have doubled since 1995. Romania is also a laggard in regional comparison tables, registering the fourth worst poverty rate in Central and Eastern Europe. Only Albania and the former Soviet Republics of Moldova and Russia have a worse situation in this respect (Fig.2).

**Fig. 1. Poverty in Romania, 1995 – 2000, % of the population**

	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	N/A

*Source: Tesliuc, Pop, Tesliuc, 2001*

**Fig. 2: Poverty in Central and Eastern Europe, 1995 – 1999, % of the population**

	Year	Poverty rate	
		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

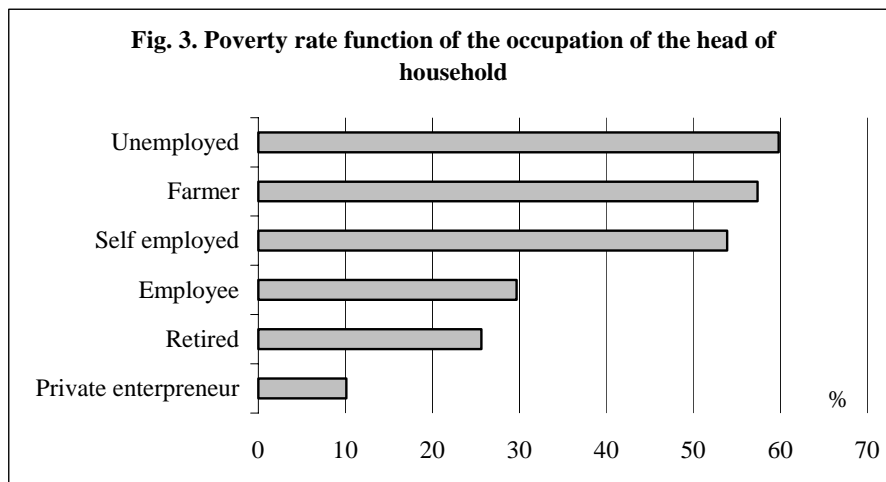
*Source: World Bank, 2000*

Note: The poverty estimates use thresholds in USD/day/adult at 1996 PPP (purchasing power parity) equivalent

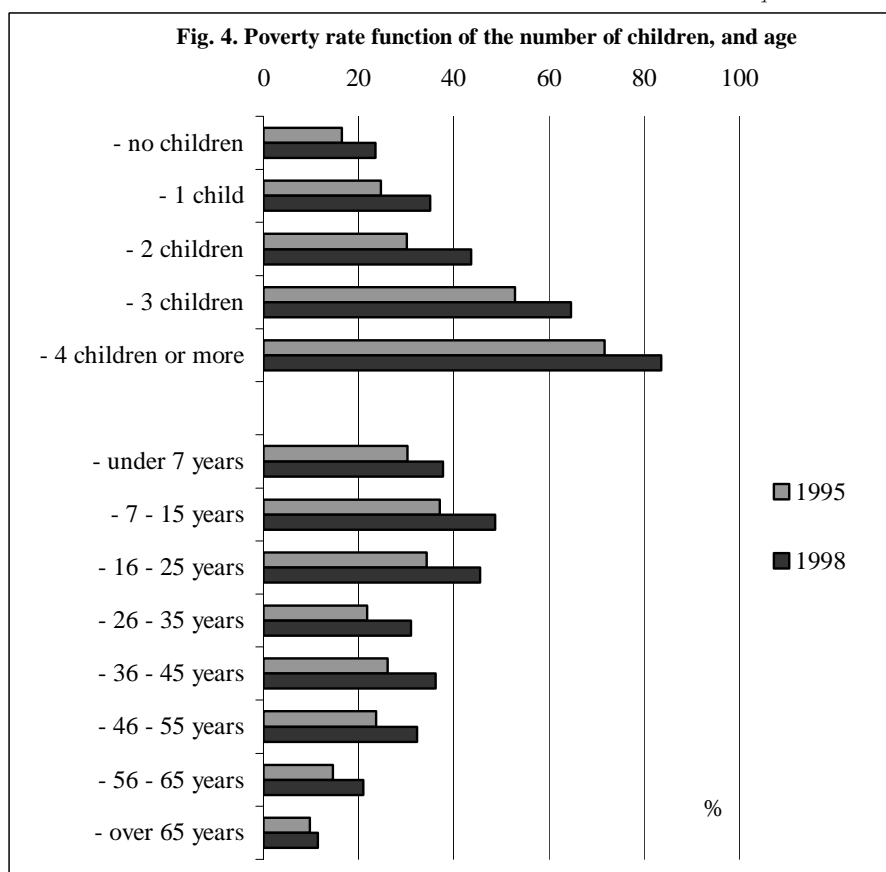
## Sources of poverty

Fig.3 shows the breakdown of poverty amongst the Romanian population. Contrary to common wisdom, poverty is most prevalent not amongst pensioners, but amongst young families with many children, unemployed and even self-employed people. Over 80% of the families with 4 or more children

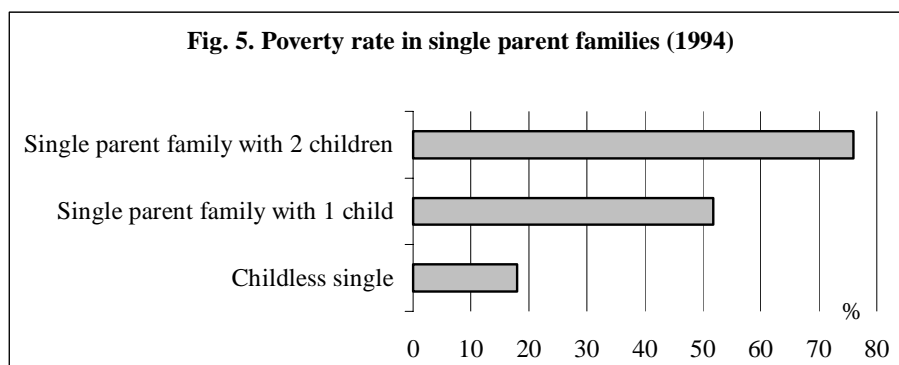
live in poverty (Fig. 4). Single parent families are also prone to living in poverty (Fig.5).



Source: Tesliuc, Pop, Tesliuc, 2001.

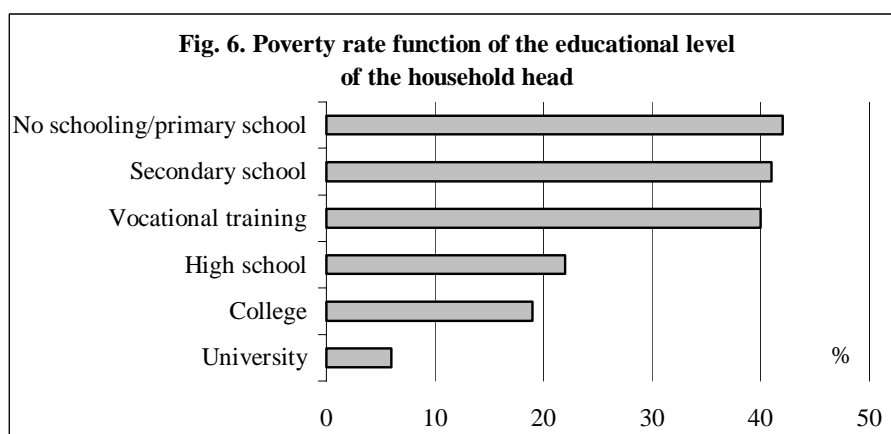


Source: Tesliuc, Pop, Tesliuc, 2001.



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

Poverty also correlates strongly with low education. A household whose head did not attend secondary school is 7 times more likely to live below poverty line, than a household headed by a university graduate (Fig. 6).



Source: Tesliuc, Pop, Tesliuc, 2001.

## Poverty alleviation

The Romanian government has employed a wide array of instruments in fighting poverty. Most of social expenditures are now accounted for by the employment related contributory benefits - the most important of these being healthcare and pensions. Only the access to education services, an important poverty prevention tool, is totally free for its beneficiaries.

The non-contributory benefits have witnessed a shift from universal coverage to means testing. The only large universal benefit is the child allowance. The means-tested income support was introduced in 1995. Having said this, the value of social benefits has decreased dramatically, during the transition years, in both real and relative terms (Fig.7).

**Fig. 7. Social benefits, % 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	
Employment subsidy	-	-	-	-	-	24.7	20.1	17.0	18.8	17.9	21.9	17.4

*Source: ICCV*

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

## Guaranteed minimum income

The guaranteed minimum income 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. Starting with 2002, income support will 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 guaranteed minimum income integrates a number of social benefits:

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

Income support will continue to be provided by the local governments, but overall 80% of funds are expected to come from the central government, through earmarked transfers. Apart from cash transfers, the income support can include goods or services.

## 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 it worthwhile to take

the pain of a regular job, and therefore do not acquire the experience needed for advancing to better paid positions.

The field research<sup>1</sup> has found little evidence that this theory applies in Romania. Due to their low administrative capacity, the Romanian authorities are hardly able to check on the income statements of the applicants for social benefits. The most likely outcome in Romania is driving the recipients of social assistance towards the black market, rather than just making them idle.

However, the law also includes safeguards. Able recipients are required to perform up to 72 hours per month of community work, and those legally employed receive a 15% higher income support.

## Implementation problems

The Achilles' heel of the Romanian income support system has been its reliance on local administration. Fig.8 and 9 paint a dramatic picture of the ability of the local governments to implement means-tested benefits. In 1995, the distribution was dealt with by the central government. Since 1996, it has been taken over by the local administration. Facing such a big administrative and financial challenge, the local governments by and large failed to implement the measure properly. In 2000, the number of families receiving income support represented only 6% of the number of 1995 – see Fig.8 and 9.

**Fig. 8. The number of families receiving income support (End of 1995 = 100)**

Year	1996	1997	1998	1999	2000
	49	26	22	15	6

*Source: Ministry of Labor and Social Solidarity*

**Fig. 9. The dynamic of the real expenditure for social benefits (End of 1995 = 100)**

Year	1996	1997	1998	1999	2000
	144.2	47.6	30	14.8	-

*Source: Ministry of Labor and Social Solidarity*

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

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

The guaranteed minimum income policy could have the same fate. The Ministry of Labor and Social Solidarity (MMSS) estimates at 600,000 –

<sup>1</sup> The Romanian Institute for the Quality of Life (ICCV), a report by Luana Pop.

750,000 the number of those to be covered, which is a number comparable to those who were entitled to receive income support in 1995. Under a comparable administrative and budgetary burden, the local administration might crack again.

By 2000, most of local authorities, especially in rural areas, had practically stopped distributing 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 governments from rural communities, which have in many cases already lost from the financial decentralization reform introduced by the previous government.

### **Financial feasibility**

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

In 1997, income support amounted to only 0.05% of GDP. Now, the government expects the guaranteed minimum income to increase this amount to 0.4% of GDP, which is an eightfold increase.

### **Conclusions**

- The guaranteed minimum income policy confirms the Romanian Government's orientation towards means testing, and away from universal benefits. This option is consistent with the financial situation of the country.
- The guaranteed minimum income includes measures to mitigate the disincentive to work associated with means-testing.
- The guaranteed minimum income 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 vulnerable 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.

- Abolishing the child allowance as a universal benefit, and instead transforming it in a means-tested aid, would be consistent with recent reforms. Large sums of money are currently spent on families that are relatively well-off, where they make an irrelevant addition to the household's income.
- Another option is to take into account, when establishing guaranteed minimum income, the difference in the cost of living between rural and urban areas, and use different thresholds. This would lead to an equalization of the real – not nominal – value of aid, whilst at the same time it would ease the burden on local authorities from rural communities.
- Based on the experience accumulated since 1995, if the central government fails to provide the resources for income support, the local administration will just be 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 the population at present, to a more manageable number.