MUTUAL LEARNING PROGRAMME:

PEER COUNTRY COMMENTS PAPER - ROMANIA

Between Early Retirement and Subsidized Employment
The issue of the over 60s on the Romanian Labour Market

Peer Review on "Activation of elderly: increasing participation, enforcing employability and working until the age of 67"

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1 LABOUR MARKET SITUATION IN THE PEER COUNTRY

This paper has been prepared for a Peer Review within the framework of the Mutual Learning Programme. It provides information on Romania's comments on the policy example of the Host Country for the Peer Review. For information on the policy example, please refer to the Host Country Discussion Paper.

Romania witnessed a full eight consecutive years of growth starting with 2000. Annual GDP growth averaged at 6.8% between 2000 and 2008. However, this came at the cost of growing external imbalances and a rather loosely conducted fiscal policy. Current account deficit reached 12% of the GDP in 2008, contracting sharply to 4.4% as the economy slumped into recession in 2009. From a low of - 7.1% in 2009, GDP is expected to grow modestly in 2010 (0.8%), with a stronger resumption of growth at a rate of 4.4% expected for 2011. The budget deficit went from a manageable 2.2-2.5% of the GDP in 2006-07 to 5.4% in 2008. In spite of severe austerity measures taken in 2009 on the back of economic contraction, the budget deficit rose to 8.3% of the GPD. Drastic measures including the reduction of salaries of state employees (by as much as 25%), as well as a 15% reduction of unemployment benefits are expected to bring back the budget deficit at around 5% of the GDP at the end 2010. Sovereign debt fell sharply from around 20% of the GDP in 2002, to 12% in 2007. As the economy slumped into recession however, debt started to mount sharply being expected to reach 35% of the GDP in 2011, still low by European standards. The total population stands currently at 21.6 million, being expected to fall to around 20.5 million by 2025. The over 65 years of age increased their share of the total population from 11% in 1992 to 14.9% in 2009. By 2025 it will most probably reach 18-19% of the total population, while projections show that in 2050 it will breach over the threshold of 30%, at 31.5%.

At the beginning of the current decade (2001), Romania had a highly distorted structure of total employment. Employment in the agriculture sector constituted more than 40% while industrial sectors were shedding workers at a fast pace and salaries were still stagnating at around the equivalent of US$ 100 (gross monthly at market exchange rate). In the meantime however, thanks mostly to subsistence agriculture[1], employment rates of the elderly segments of the labour force were still rather high at around 36% for the over 65 years of age and 50% for the 55-64. This, however, started to change since 2003. As FDIs started pouring into the country's economy, the structure of employment started to shift. Between 2003 and 2008 unemployment fell from around 7.8% to 4.01% (national definition) reaching a low of 3.5% in mid 2008. In terms of the harmonized definition, rates fell from 8.1% to 5.4%. The share of services in total employment went up from 34% in 2003 to 39% in 2008. Industry also grew slightly from 29% to 31% while agriculture significantly declined reaching 28% of total employment by 2008.

Table no.1: Employment rates for selected age groups of the working age population;

Employment Rate (Activity rate)	1996	2000	2005	2007	2008
15-64 years of age	65.8 (70.8)	63.6 (68.8)	57.7 (62.4)	58.8 (63.0)	59.0 (62.9)
55-64 years of age	50.1 (50.5)	50.1 (50.5)	39.4 (40.4)	41.4 (42.4)	43.1 (44.2)
over 64 years of age	32.3 (32.4)	35.9 (35.9)	14.6 (14.6)	16.0 (16.0)	15.2 (15.2)

[1] Household production for their own final consumption type farms;

difference (15-64) – "over 64", in pp. (employment rate)	33.5	27.7	43.1	42.8	43.8
Difference (15-64)-(55-64), in pp. (employment rate)	15.7	13.5	18.3	17.4	15.9
Activity rate 55-64 as % of EU-27 average (=100) [EU 15]	-	127 [123]	89.2 [85.5]	89.6 [86]	91.8 [88.4]
Employment rate 55-64 as % of the EU-27 average (=100) [EU 15]	-	135 [132]	93.1 [89.1]	92.6 [89]	94.5 [90.9]

Source: National Institute of Statistics of ROMANIA (LFS/Amigo);

Developments outlined above were accompanied by a fall in employment rates of elderly segments of the labour force from a 35.9% employment rate for over 65 in 2000 to half this rate (15.2%) in 2008. For the 55-64 employment rates went down from 50% in 2000 to 43.1% in 2008 while activity rates for the same age group declined from 50.5% in 2000 to 44.2% in 2008. Elderly segments of the labour force were no longer able to adapt to the new or different content jobs generated in the economy. It is true to say also that a marked increase in pensions, following the parametric reform of the 1st Pillar, induced a perverse incentive towards idleness, especially as the strengthening of the link between contributions and benefits was not accompanied by more stringent eligibility conditions for early retirement and invalidity pensions[2]. Increased flows of remittances coming from youngsters working abroad also played their part though up until now their effect on this particular segment of the labour market is hard to discern[3].

The Unemployment Insurance Act passed in 2002[4] provided a full range of active measures to help workers displaced by massive restructuring back into work, while in the meantime trying to induce employers into hiring from all segments of the labour force, its elderly segments included. As such, Law no.76/2002, further amended as regards the matter at stake in this paper, In 2005[5] it provided for two types of subsidy to be granted to employers: (1) if they hire from the ranks of the unemployed individuals above the age of 45, and (2) if they hire individuals three years before their statutory retirement age[6] or alternatively three years before being eligible for early retirement. The subsidy runs in the first case for 12 months and it is equal to the national minimum guaranteed gross wage for each individual hired in compliance with legal provisions stated in the main body of text. In the former case it also includes an exemption from the payment of contributions to the unemployment insurance fund, counted for the same period of time. Labour contracts for which the employer receives the subsidy, cannot be discontinued earlier than two years after their

[2] The Romanian Pension system is fully contributive (min. contribution period is 15 years, full contribution period is 30 years for women and 35 for men). No pension-type benefit can be granted without individual contribution to the system (combined employer and employee). Only recently, starting in 2009, a small non-contributive, complementary component has been introduced so as to elderly income falling below a threshold of approx. RON 400 per month (EUR equiv. at market rates = 100).

[3] Most recent UN data contained in the UNDP 2009 Human Development Report that deals specifically with the theme of international migration puts remittances flows for Romania (2007) at the equivalent of 5.6% of the GDP and as ratio to the total flow of FDIs at 0.9%

[4] Unemployment insurance in Romania is also entirely contribution-based.

[5] Emergency Order in Council/Ordonanta de Urgenta no.144/2005;

[6] Currently 59 years of age for women and 64 for men;

conclusion[7]. In the second case, the subsidy only represents the equivalent of the national minimum guaranteed wage and it is granted up to the time when the employee hired under the conditions of the law reaches statutory pension age (i.e.: old age) or alternatively is eligible for early retirement[8] These two labour market interventions (*LMI*) are now the main levers via which, successive Governments tried tackling the increasing propensity towards inactivity (i.e. read early retirement in whatever form it might come) of the over 60s. More recently, as the global economic crisis has affected the Romanian economy, with both the state as well as the social insurances budgets under increased strain, the Government has promoted a new Unitary Pension Act which among others provides for an equalization, by 2015, of the statutory retirement ages for both women and men, at the age of 65 (under current provisions statutory retirement age for women would have reached 60 by 2015, while men would have reached 65 by 2015). These will have to act as disincentive enough for idleness, especially as the years ahead will witness a thorough decoupling[9] of pension-related earnings from salaries and a much dreaded, by pensioners, re-coupling with the more modestly growing CPI inflation (i.e. commonly referred as the “inflation rate”).

2 ASSESSMENT OF THE POLICY MEASURE

The policy presented to us by the Host Country Paper makes for a very good example of a pro-active stance with regard to the issues confronting a modern labour market in a highly developed, export-oriented economy. It also highlights how policies such as early retirement can be reversed (changed) and how with the help of active labour market measures this change might be rendered, to a certain degree of course, effective. In the meantime, it points to the fact that while different policies applied by the Government can play a major role with respect to developments in the labour markets, a lot depends on the soundness of market fundamentals in their more general terms with special regard to competition rules, property rights as well as to the tightness of “the fabric” of both the society and the market, something that generally comes after prolonged periods of stable development. It is this that gives the state the means to intervene on the markets and make use of public resources not only to influence the market and market operators but also to channel private investment into a particular direction (see the example of the Dutch Life Savings Accounts). It is practically into this way that Anti-Cycle policies are working.

In this respect policies pursued by the Dutch Government, at least to their degree of sophistication and involvement of individuals, enterprises and social partners are in marked difference with what a Government of a country in Post-Transition (e.g. in this particular case Romania) can rely on, especially with regard to financial resources and involvement of social partners.

Of course, in their general aim and shape, the measures enacted by the Romanian Government are similar as they count, broadly speaking at least, as a subsidy directed so as to encourage employers to employ older workers and thus prolong their active life at least to their statutory retirement age if not more. However it is here where similarities stop. When looking into the details, the Dutch measure looks far more sophisticated, involving to a far higher degree, both the worker as well as the social partners, particularly enterprises. The Romanian measures are, from this perspective, just blunt, classical subsidies, only involving the state (the unemployment insurance budget), leaving the individual aside, while

[7] Unfortunately there are no in-depth studies or analyses with regard to the efficiency of these measures;

[8] Early retirement can be granted 5 years before the statutory age and only for individuals that have exceeded full contribution period by 10 years.

[9] We are hereby referring to the indexation mechanism of the “pension point”, the base unit for pension calculation in Romania. The current law links its indexation to the average salary (45% of the gross national average salary); The new law, currently debated by Parliament will link its indexation with CPI variations.

giving the employer as little a say as possible, mostly due to concerns, not entirely founded though not also entirely un-founded, that funds might get misused.

This shows actually how much in their intimate design and subsequent application, labour market interventions owe to the particular level of general economic development. The Dutch approach is inherently sophisticated as it operates in what is a mature market. The Romanian approach strikes by its simplicity as it is typical for what we call an emerging market.

From this point of view alone, it is not surprising that intake rates (see table this section) of the Romanian measure are relatively low. However, there is also a difference in the way in which two governments have approached the windfall in revenues that came with the unprecedented period of economic growth the world economy recorded throughout almost all the first half of the current decade, the two last years apart.

It is of course commending to mention that the Dutch Government has acted somehow in a counter-cycle manner, as it has pumped excess revenues deriving from higher growth into measures designed to help employment of the disadvantaged and marginal groups, discourage early withdrawal from working life and promoting flexible working arrangements. However it is not to be forgotten that it was building upon an economy which has enjoyed several longer periods of growth since the end of WW-II.

For the Romanian Government, none of this was a possible option. Growth had finally arrived at the beginning of this decade after almost two decades of economic stagnation. Firms and individuals were more than eager to boost their earnings and satisfy their long repressed needs. In the meantime, foreign investors had to be lured into the country by low taxes and the more it could have been cut from social contributions and taxes, the better. As such, the Romanian Government has cut contributions for pensions aggressively between 2004 and 2008 (by around 6 pp.). In the meantime contributions for the unemployment insurance fund fell from a combined rate of 4% at the end of 2004 to 1% by the end of 2008. A Flat-rate income tax of 16% has been introduced in early 2005. It was clear enough that active labour market measures were not and could not have been the priority for a Government desperate to foster growth for a population deprived from it for almost half a century. This more than fully explains why allocation of resources for active employment measures was not a priority but also why individuals and companies have paid scant attention to what looked more like a bureaucratic juggle than a true support for a market, finally making it on its own.

Table no.2 Total no. of registered unemployed and beneficiaries of specific LMI for elderly workers:

Number of beneficiaries	2005	2006	2007	2008	2009
Total no.of registered unemployed	522967	460495	367838	403441	709383
Total no.LMI beneficiaries (% of total reg.unemployed)	373383 (71.4)	386257 (83.9)	395255 (107.5)	330837 (82.)	304558 (42.9)
Total no.benef.subsidies-3 years bef.retirement (%of total no.of LMI beneficiaries)	474 (0.13)	454 (0.12)	386 (0.10)	252 (0.08)	58 (0.02)
Total no.of benef.subsidies-older than 45 years (% of total no.of LMI beneficiaries)	13050 (3.50)	15156 (3.92)	16888 (4.27)	12672 (3.83)	4591 (1.51)
Unemployment rate national definition (%)	5.9	5.2	4	4.4	7.8

Source: Romanian Ministry of Labour, Family and Social Protection;

Of course this development has proven to have more than limitations. Increased reliance of the economy on inflows of foreign capital, which has prompted hasty appreciation of the national currency and thus a loss of competitiveness, combined with the opening of the labour markets in the developed western part of the EU, thus drying the local market of labour (both of the more as well as of the lesser qualified), have rendered the economy vulnerable to random exogenous shocks. When economic crisis hit Romania in 2008, it had to rely on the sort of deflationary mechanics that would have been more familiar to Keynes monetary theories of the early twenties than to the ones that inspired the recovery from the Great Depression of the 20th century. This has practically nullified the effect of the fiscal relaxation measures enacted before (the 16% flat rate income tax and the 1% combined contribution rate to the unemployment insurance fund still remain in place) rapidly turning boom into bust. During 12 month unemployment (national definition) grew swiftly back to levels observed five years ago. Contraction of the demand has rapidly reduced public budgets revenues which resulted in the unemployment fund going into deficit from the beginning of 2009. Accordingly, after paying for rising passive unemployment benefits, little remains to cater for active measures, especially when vacant jobs are scarce and employers are reluctant to employ workers when faced with both hugely damaged balance sheets as well as uncertain prospects of economic recovery.

In this respect solely, concerns of the Romanian Government regarding its own rapidly growing debt burden, combining with a hard pressed drive to pass more of the effort for training and HR development on individuals/households and enterprises, are a match for concerns of an already debt-laden Dutch Government.

3 ASSESSMENT OF THE SUCCESS FACTORS AND TRANSFERABILITY

Labour market interventions fully classify as discretionary stimulus of the fiscal kind. Therefore they are hugely dependent on the state of public finances and more generally on the broad macro-economic picture.

The Dutch Government in this respect has been relatively successful as it had activated the stimulus in times of fiscal abundance, while capitalizing on the inherent assets of a developed economy and a thoroughly organized society. The Romanian Government on the other hand, has been less successful not because it acted in times of plenty when nobody actually needed such measures, but because it operates in a rudimentary market economy with a society still haunted by the trauma of the totalitarian regime and which still harbours a "*Ferente Danaos et dona ferentes*" mistrust towards the state and its actions. European countries might as well spend a significant part of this incoming decade trying to decrease and control huge public debt governments have accumulated, not just trying to battle the current crisis but also before, while indulging in generous transfers which had little prospect of rendering results when tide suddenly turns. Therefore, it is more than unlikely that the subsidy-related features of the Dutch interventions can be translated from the Netherlands to Romania.

Under the current macro-economic arrangements Romania lacks the possibility to engage even in the most modest type of fiscal stimulus, not talking about monetary stimulus. It might be also, given the current economic context, that a more frugal, *defined-contribution* rather than *defined-benefit* oriented approach to labour market and social protection policies would get potential transferability to the Netherlands. What stems from the Host-Country Paper itself is the necessity for the government/state to become frugal and this in the very proper term. Debt driven governmental policies can no longer afford any type of subsidy. Individuals and companies must pick up the note or they will soon face dire consequences. In the meantime one will have to realize that increasing retirement ages or linking them closely with-life expectancy at birth will not yield much. Life-expectancy at birth is one parameter, but next to it comes healthy life expectancy at birth and soon enough we will have to count effectively-productive life expectancy at minimum labour market entry age. Thus if people have a desire to rest when getting grey, they will not only have to work more but actually save more and work more intensely throughout their young productive years,

4 QUESTIONS

1. How is the Dutch Government planning to tackle its public debt problem while in the meantime not putting into jeopardy its employment rate achievements?

2. Do the Netherlands colleagues think that raising retirement age alone is the solution for tackling the slide into inactivity after the age of 60 or rather it would be more feasible to encourage people to work more and save more while in their young, productive age, so as to enjoy some rest in the old age while in the meantime not excessively burdening state finances and future generations of course?

3. The idea of having a mid-life career break is more and more discussed though rarely brought straight into the open. How far are the Dutch authorities prepared to go with this initiative and how it has been actually received by social partners and the wider public?

4. As Europe will probably spend most of the decade trying to reduce public debts and will likely experience sluggish growth, does the Dutch Government think that the high employment rates for which it has made commendable efforts for the last decade can be still maintained?

5. What incentives will be put into place so as to encourage individuals and enterprises to invest more into training in times of economic strain, especially if these are likely to continue?

6. The paper stated that the only sectors which kept growing in terms of employment were administration and education. Is the statement a reflection of pre-crisis trends or is it also true for the current recession period? If the latter true, what is the explanation for it?

ANNEX 1: SUMMARY TABLE

Labour market situation in the Peer Country
• Romanian labour market thoroughly reflects the peculiar conditions of a post-transition economy. • Measures to tackle propensity towards inactivity of the elderly have been taken but their intake rate remains small. • Activity rates of the elderly are on the fall currently. While the economic prospects still remain uncertain, though dare to say more hopeful than for mature markets, measures like the proposed increase of the statutory retirement age, as well as the hardening of eligibility conditions for invalidity, as well as early retirement give hope that the current trend might see as well a reverse.
Assessment of the policy measure
• The policy measure as outlined by the host country is a good example of innovation in mature market economy. • However, the policy combines both features of pro and anti-cycle policies thus being vulnerable to market turns of the tide. The current burden of public debt might render its more sunny aspects untenable with the more grim ones (increasing retirement age above 65, shifting the burden towards enterprises and individuals and the contemplation of what can be a compulsory mid-career break) getting closer to reality.
Assessment of success factors and transferability
• Transferability potential for such measures remains low. They are of course attractive in their design and might lure emulation. • However, the current and likely future state of the public finances precludes any approach that would increase, even marginally, public expenditures. • The only lever at hand remains the thoroughly un-popular resort to increase retirement age. Else, there can be fiscal stimulus, though not of the immediate resort, in the form of incentives for higher savings and more intense work for individuals while in their prime age. Scope maybe for the revision of the working time directive?
Questions
• Mainly focus on the sustainability of such measures in times of economic austerity and slow growth. • Also focusing on the capacity of maintaining the high employment rates, the Netherlands currently enjoys, while in the meantime drastically cutting public expenditures so as to reduce the burden of public debt.