

Need for more fairness in the pension system

Given the fast rising share of people in pension age, it is important that Moldova's social security system performs well in preventing poverty and providing income replacement for the elderly. However, while outright poverty among the old people is reasonably low, a large share of people in pension age is almost poor. So while social security can prevent outright poverty, the pension system does not provide a sufficient pension. Indeed, at the moment there is only little incentive to pay contributions once a minimum pension is secured. Especially, as the government rewards people with low pensions further by granting them top-up payments. To make the system fairer and more attractive the government needs to make a clear division between social insurance ("you get what you pay for") and social assistance which protects the poor.

Background

Like in many other countries, Moldova's population is aging fast. This increases the need for a well working social security system for the elderly. Essentially, social security for the elderly needs to achieve two objectives: Firstly, it should provide an income insurance which upon retirement provides the elderly with a pension high enough to replace a reasonable share of their previous wage incomes (income replacement). Secondly, for those in retirement age who do not have a sufficient income from other sources, social policy should guarantee a subsistence income that allows them to meet their basic needs and avoid poverty (poverty prevention).

Old-age poverty in the current system

Measured against those two objectives, Moldova's social security system for the elderly is quite good at preventing outright poverty. The absolute poverty rate (according to the official definition) has been falling consistently since 2009, with around 15% of households headed by pensioners living below the poverty line in 2014. This is only moderately higher than the poverty rate of average households and in magnitude similar to other CIS countries. However, while outright poverty is low, a large share of people in pension age is almost poor with average per head income (pension, wage, remittances, etc.) of MDL 1,480 (USD 75) per month. But while poverty prevention works rather well, income replacement is not so successful.

Absolute poverty rates



Sources: National Institute for Economic Research Moldova

Existing social security instruments

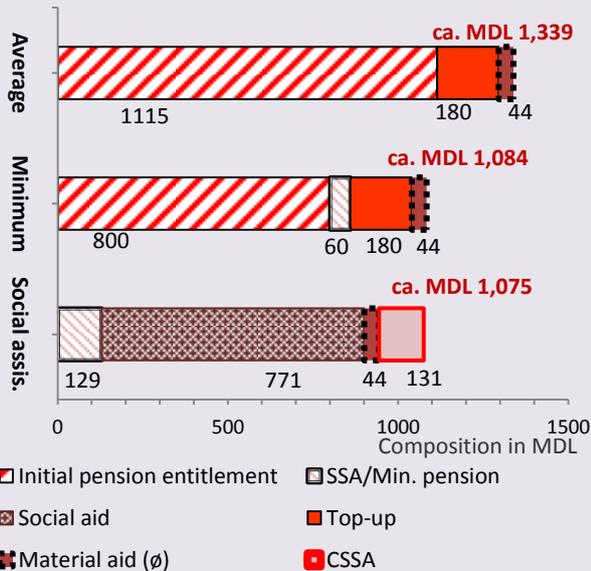
The problem lies in the way Moldova's social security system for the elderly is organised. Indeed, a review of the existing system shows that there is no clear division between social insurance and social assistance. For example, a *minimum pension* of MDL 860 is paid to a large share of pensioners as long as they can show 30 years of employment; regardless of how much they actually contributed during that time. Thus, the minimum pension is not really a social insurance instrument but rather resembles social assistance. Also, given that in 2015 the average pension was only MDL 1,115, there is very little incentive for most people to contribute beyond the 30 years required to reach the minimum pension. Not only is this unfair, it also means that ever less people are willing to contribute to the pension system.

Furthermore, in 2014 the government introduced a monthly pension top-up of MDL 180 for pensions below MDL 1,500. While well-intentioned, the measure greatly reduced the motivation to earn a pension of more than MDL 1,500.

The inherent unfairness and incentive problem becomes even more evident when comparing the typical incomes of those relying on social assistance with those who receive a pension. In fact there is little difference in the income levels, regardless if a retiree depends on social assistance, receives a minimum pension or reaches the average pension level. Contributing to the system just does not pay off. The fact that there is a large number of support measures

aimed at the elderly with wildly varying entitlement criteria, further complicates the situation. Pensioners constitute the most important share of the electorate, and over time “give-aways” before elections have created the existing patchwork of instruments.

Representative cases of old-age pensioners



Sources: Own analysis based on Household Budget Survey

Policy recommendations

Given the short-comings of the current system, the reform strategy for the government should be a clear division between social insurance and social assistance – between income replacement and poverty prevention. To achieve this, the current minimum pension should become means-tested and be incorporated into the general social assistance system (guaranteed minimum income). Only those elderly, who cannot pay for their basic needs, will receive income support. However, the government needs to ensure that the minimum guaranteed income is raised gradually to reflect the actual subsistence income level.

Incorporating the minimum pension into the social assistance system should free up money for the actual pension system. This money should be used directly for the pension fund to increase the replacement rate. In addition, the government should abolish the current pension top-up and use those funds also for those pensioners who earned a regular pension. Finally, the government could consider introducing a base pension financed from the state budget which would increase the average pension for those who contributed towards a regular pension.

Conclusions

Improving social security for the elderly does not require a huge reform but rather a number of smaller measures that follow our strategy. This should prove popular among the population as there is a widespread perception that the current system is unfair. Indeed, the result would be a much fairer pension system which rewards those who genuinely contributed towards receiving a state pension and makes it much more attractive to do so. At the same time the government would have a powerful social assistance instrument which prevents poverty for those who do not have any other income sources.

Authors

Jörg Radeke, radeke@berlin-economics.com
 Katharina Kolb, kolb@berlin-economics.com

Note: A more comprehensive analysis of the topic is provided by the Policy Paper PB/02/2016 “Providing social security for the elderly”

Available at: www.get-moldau.de

German Economic Team Moldova (GET Moldova)

GET Moldova maintains a dialogue on economic policy with decision-makers of the Moldovan government since 2010. It is funded by the Federal Ministry of Economic Affairs and Energy within the framework of the successor of the TRANSFORM programme of the German government.

Editors

Dr Ricardo Giucci, Jörg Radeke

Contact

German Economic Team Moldova
 c/o Berlin Economics
 Schillerstraße 59
 D-10627 Berlin
 Tel: +49 30 / 20 61 34 64 0
 Fax: +49 30 / 20 61 34 64 9
 info@get-moldau.de
 www.get-moldau.de