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SOCIOMETRY LABORATORY

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INDEXATION OF PENSIONS - SYSTEM SUBTLETIES OR ECONOMIC ABUSE OF STATE!?

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1. General considerations

Pension is the only source of livelihood for the retired persons. Pensions issue is not just a simple approach to the deplorable economic situation of the country but also a reflection on precarious life conditions of a significant part of population. Retirement and pensions are components of the security system, which affect both the generations of retirees and pre-retirees.

The pension system is attractive neither for current generations nor for those who will get into the system. The system is neither adequate nor sustainable, reflecting a replacement rate that amounts only to 28.4% (2012). **The system does not fulfil its main objective - ensure sufficient income to retirees, for those citizens who have made consistent contributions throughout their entire active life.**

The Republic of Moldova has poor experience in significant changes in this respect; the pension system was updated in 1998, while preserving categories of categories (according to the Soviet pension system developed in 1964 and amended, in its turn, by the USSR Law on ensuring Soviet citizens with pensions dated 15 May) [1]. From 1990 till 1998, the Republic of Moldova had a Soviet pension system, which for economic reasons, underestimated the real value of Moldovan citizens' income. Thus, citizens who retired during Soviet times prior to the reform of 1998-1999 still face a significant gap in retirement payments, as compared to those who retired after 1999. This is evidence of social and economic inequality. During the first decade of independence, the system lacked transparency and the state found itself in the situation where it was not able to pay pensions and salaries[2]. In accordance with the National Human Development Report, for 90% of pensioners the only income was the pension guaranteed by the state from the Social Fund[3].

The pension system is vulnerable and the main problem is that the amendments to the pension system in Moldova, made in 1998-1999 based on the features of the Soviet system, underestimated the principle of impartiality in terms of social categories. Thus, following social segregation, certain social categories pensions were calculated unevenly compared to others. Under these conditions, the representatives of academia and healthcare professionals found themselves at the level of the needy and the poor, representatives of police, justice system, civil servants and state dignitaries at the level of those most privileged, while peasants, agricultural workers - below the poverty line.

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1 USSR Law on ensuring Soviet citizens with pensions dated 15.05.1990.

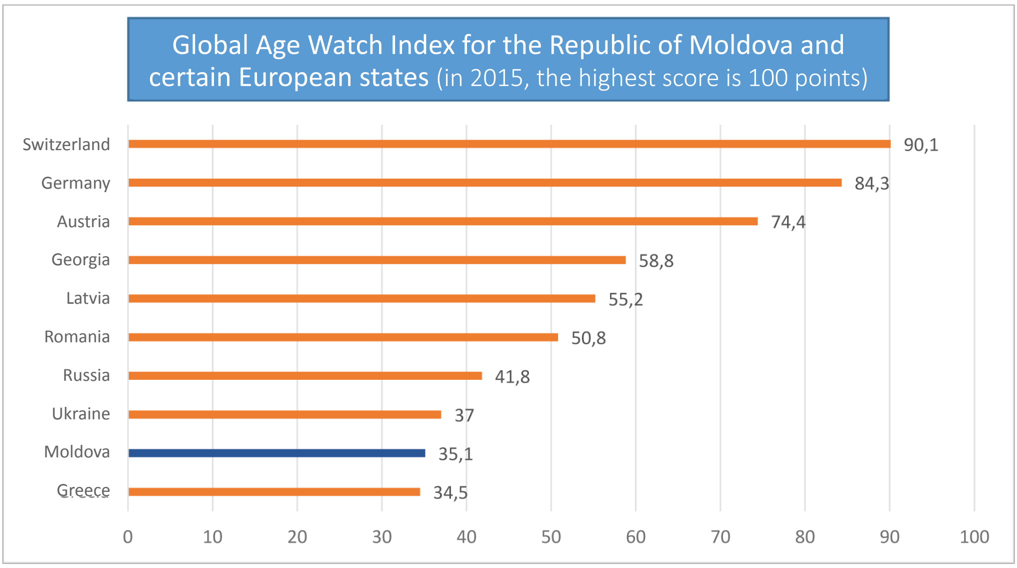
2 1997 National Human Development Report "Social cohesion", UNDP, p.46

3 1997 National Human Development Report "Social cohesion", UNDP, Moldova

The pension system has exhausted all its reserves, violating the human rights to a decent life and a secure old age. Government has just stated the need for reform so far and confines its actions to annual indexation of pensions, which is not enough for solving the problem of most retirees who continue to receive a retirement payment that is well below the subsistence minimum in the Republic of Moldova[4]. The state fails to ensure a decent life for pensioners, while the system is not sustainable financially and socially. For the retired persons, their pension is a continuous struggle for survival and the indexation only diminishes slightly the poverty along with ageing.

The country ranks rather low in Global Age Watch Index both in comparison with neighbouring countries and the European Union states. In comparison with advanced EU countries, this index is more than twice lower.

Analysis of current pension systems in terms of security, economic fairness and fundamental human rights leads us to the conclusion that, at least with reference to pensions, fundamental principles of market economy, accepted by most countries, are knowingly violated by national legislation governing pensions. What is denied is the direct property right over the most important financial asset created by each person painstakingly throughout the entire active life[5].



Source: *http://gtmarket.ru/ratings/global-age-wath-index/info#moldova*

[4] http://www.investigatii.md/index.php?art=322

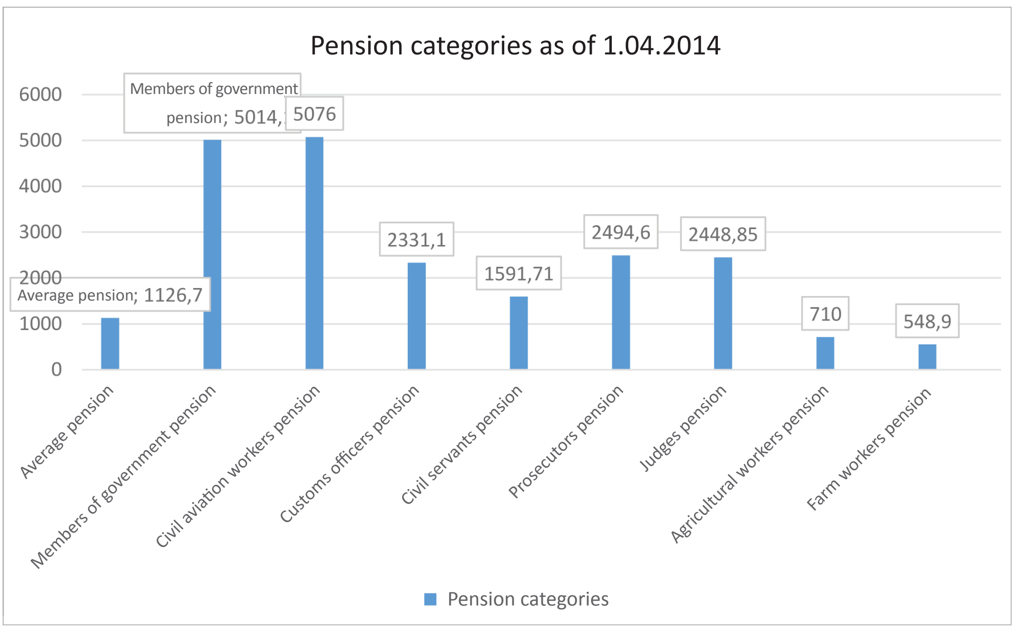
[5] Oleg Verejan, Realities and prospects concerning future pension in Moldova.

2. Discriminatory pensions and calculations within the system

Over 90% of retirees have a pension of less than 1000 lei, which considerably affects the wealth of the elderly and does not allow them to have a decent life. Therefore, the state does not have comprehensive strategies to improve the situation in this respect. Only 3-4% of the elderly people can afford to have everything they need, all the others are living on the edge of poverty.

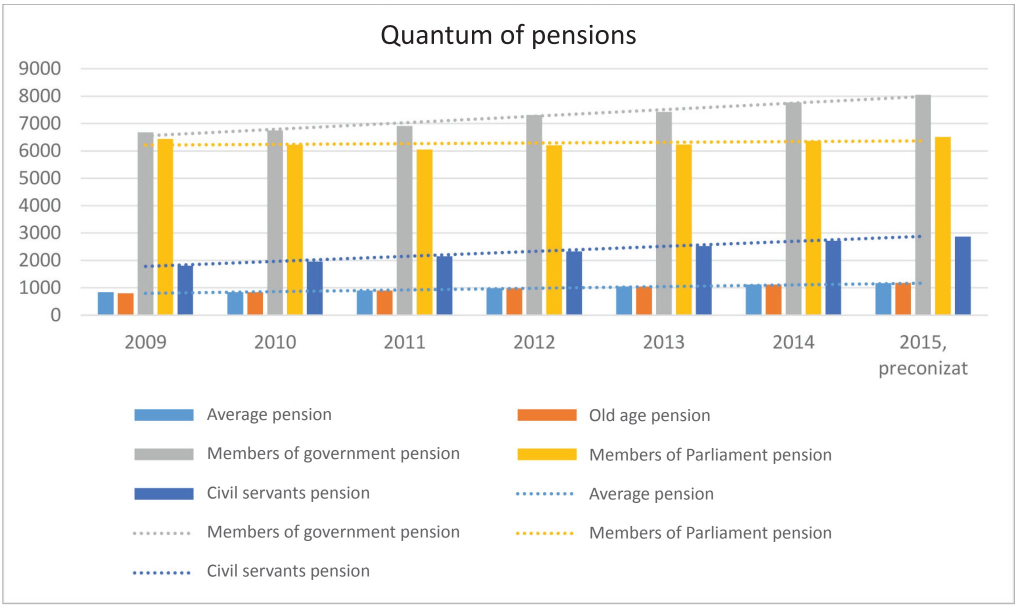
High rates of pension reduced average real retirement payments to a minimum. There is no correlation between contribution and right to pension, which is unfair. Within the range of pensions, there is an obvious polarization between "elite retirement" and "common retirement" and this phenomenon is not linked to the state or the system.

Those persons who have fulfilled a full contribution period (30 years and more) are not protected either. **The connection between contributions and right to pension is becoming increasingly weak, insignificant along with the extension of working life period.** The system does not provide the opportunity to compensate for the years of contributions to pension above retirement age or get some dividends during the retirement period.



Source: *NSIH*

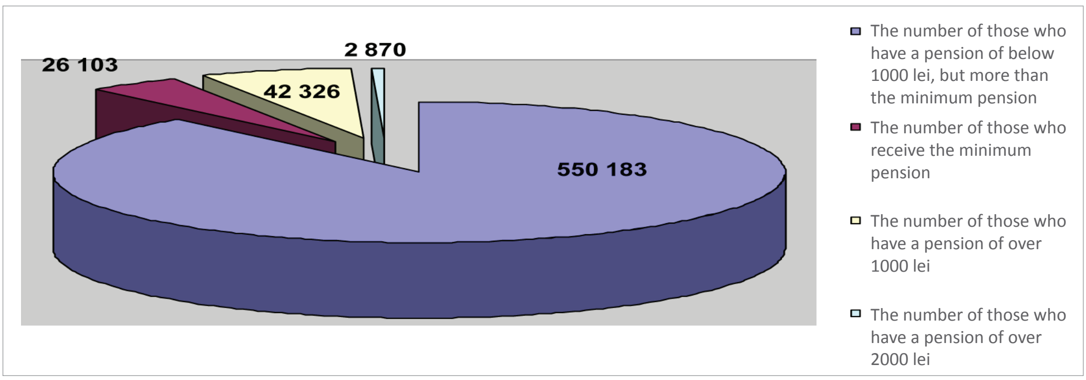
This is an element of inequality, if we consider these differences between the highest, average and lowest pensions. This situation is hard to understand and does not respect the principles of social development and human fairness. minimum pension is almost two times. Under these conditions, the person who has worked honestly and fulfilled a full contributions period is discriminated by the person who has contributed less, for subjective and objective reasons.



Source: *Citizens Budget, 2015*

The difference between the average pension in the country and the minimum pension is about 25 times higher. The highest pension in the republic of Moldova is over 30 000 lei. The difference between the average pension and the Irrespective of how much the citizen contributes, **after 15 years of contributions, their share is insignificant. The pension does not reflect the substantial contributions made during the second period after 15 years of working life.**

Share of main categories of pension (2011)



Source: *NSIH*

It is required to reduce the category of privileged pensioners within the pension system. The pension of deputies and members of government accounts for 80% of full minimum nominal wage (December 2007) and changes along with the increase in their salary. Civil servants can benefit from pension 5 years before their retirement age and receive 70% of their average salary. By contrast, the dignitaries' pensions account for 70-80% of their own salary, which is, anyway, much more higher than the average salary in the country. At the other end of the system, there are common retirees who do not receive even 40% of the average salary in the country. Therefore, the contributor will have a ridiculous pension, regardless of its indexation.

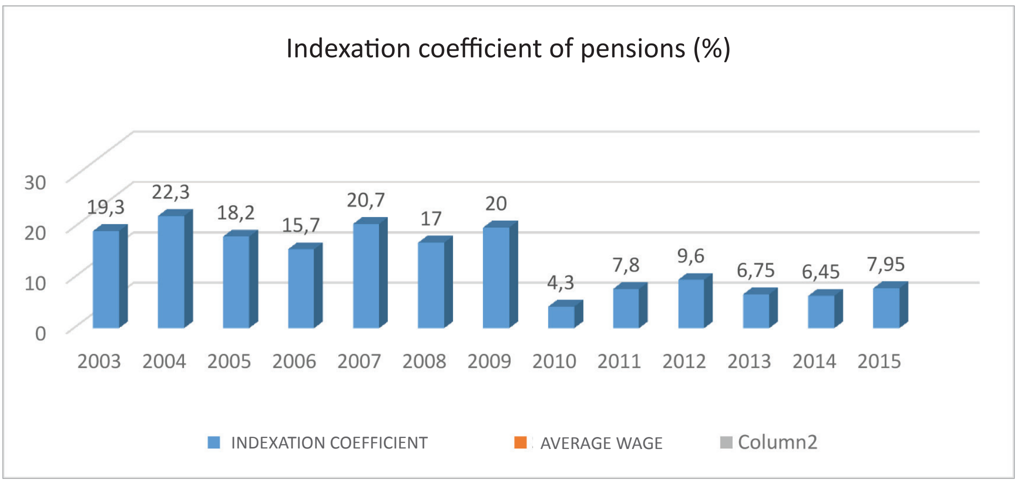
3. Indexation of pensions is unfair

Annual indexation of social insurance pensions is provided for by legislation. **Indexation coefficient is the average between annual increase of the consumer price index and annual increase of average wage in the country for the previous year, determined as established by the Government.** Only the part of pension paid from the state social insurance fund budget is subject to indexation.

The first indexation was carried out in 2003. In April 2004, pensions were increased by 22%, in 2005 – by 18.2%, in 2006 – by 15.7%, in 2007 – by 20.7%, in 2008 – by 17%, in 2009 - by20%, in 2010 – by 4.3%, in 2011 – by 7.8%, in 2012 – by 9.6%, in 2013 – by 6.75%; in 2014 - by 6.45% and in 2015 - by 7.95%[6].

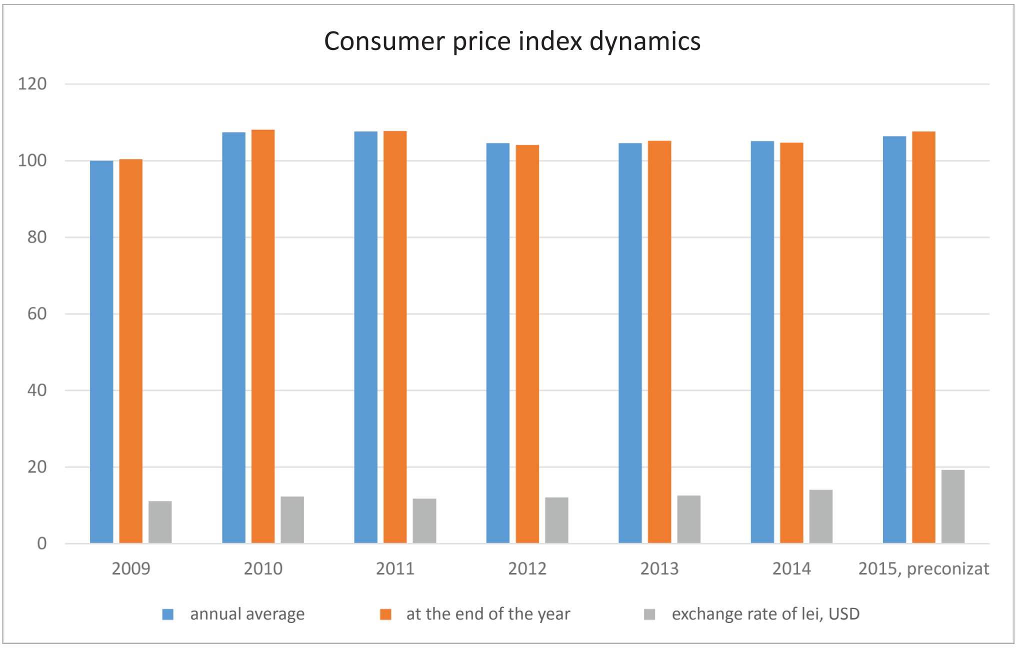
The average pension amount during the last indexation ranged at 1167 lei. Data show that there was a considerable decrease in indexation over the last 5 years (2010-2015), which result in further vulnerability of pensions and retirees' life.

There is a huge discrepancy in pension indexation over time in the country. Since 2010, the coefficient of indexation is minimal in relation to the period before 2009. For instance, as a result of pension indexation, persons with low pension benefits, like those employed in agriculture, benefit from an insignificant increase (less than 100 lei), while those who receive a pension payment of 4000 lei enjoy a significant increase against the background of price increases. Persons with low pension benefits receive a very low increase in relation to their purchasing power.



Source: *NSIH, NBS*

[6] Decision Nr. 61 dated 06.03.2015, Monitorul oficial, Nr. 58.



Source: *Citizens Budget, 2015*

Consumer prices usually have growth rates higher than the income provided by indexation. Consumer prices are constantly increasing, compounded by seasonal price fluctuations and this population category is not protected, while their vulnerability is maximal under the conditions of poor income sources.

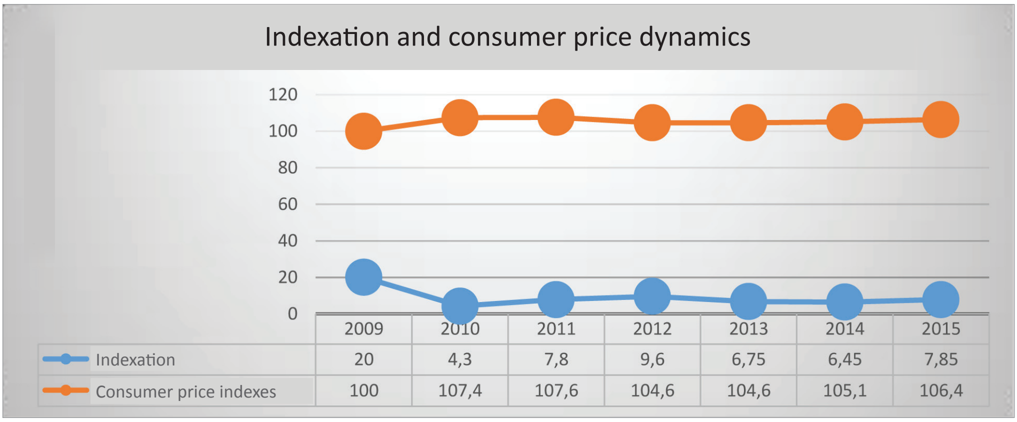
In the structure of consumption expenditures of the elderly is seen a predominance of expenditure on foodstuffs (48,8%), housing equipment and routine maintenance (26,5%) and healthcare (9,3%). In spite of pension increases, they are not sufficient for providing for the basic needs of the elderly, accounting for only 83% of retirees' subsistence minimum and reaching the amount of 1343,7 lei. [7] This situation is aggravated by ageing process that is dependent on the health system especially after the age of 70.

[7] Olga Gagauz, DEMOGRAPHIC BAROMETER, LIFE QUALITY OF THE ELDERLY, 2015

Table 1. Consumer price indices dynamics

Price indexes, by economy sector, previous year=100 by Indexes and Years						
	2009	2010	2011	2012	2013	2014
Consumer price index for goods and services	**100,0**	**107,4**	**107,6**	**104,6**	**104,6**	**105,1**
goods - total	97,4	106,5	107,0	104,0	105,5	106,1
foodstuffs	94,4	105,7	108,4	103,8	106,6	106,5
non-food items	99,7	107,3	105,8	104,2	104,3	105,5
services	108,2	109,1	108,8	106,2	102,6	102,5

Source: *NBS*



Over the last period of time (2010-2015), we see a decrease in indexation in comparison with 2003-2009 and a constant slight increase in consumer prices. Thus, indexation for the period 2010-2015 is completely offset by the consumer price increase.

Pensioners also face the risk of national currency devaluation. The increase in exchange rate against the reference currencies is the main reason for the poverty of all social categories, including the retirees, from 2009 till 2015. **Indexation compensates only partly for the consumer price increases but does not cover the galloping inflation of the last three years.**

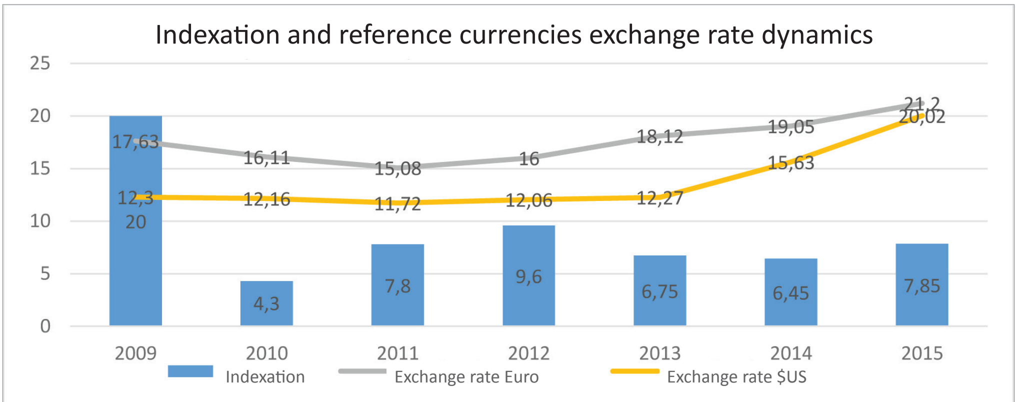
At the same time, high inflation rate reduces the real value of the wage base for the next categories of pensioners (pre-pensioners), of current retirees' pensions and value of benefits. Inflation, against the reference currencies, reduced drastically the protection of pension beneficiaries and emphasized their extreme poverty. Moreover, indexation failed to offset this risk both in the past and nowadays.

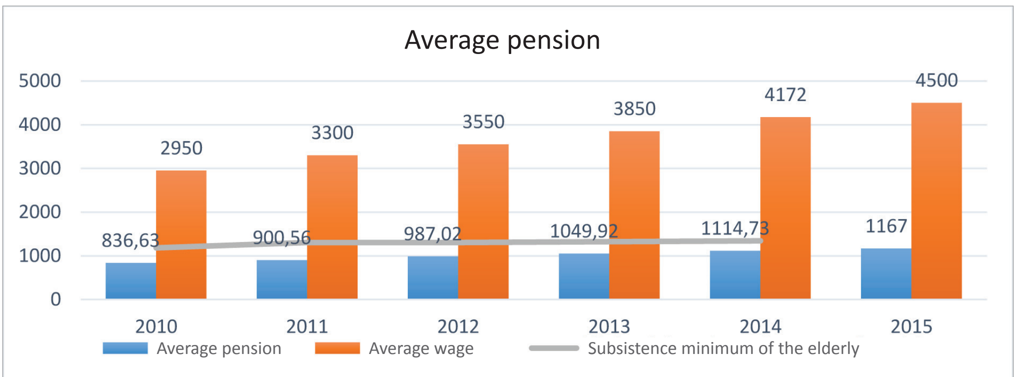
4. Indexation of pensions – retirees become poorer

Average pension has increased in amount over the recent period, but there is an ever increasing gap between average salary and subsistence minimum of the elderly and an increasing discrepancy of income as well. The real income of pensioners decreased for more than two times the last two years.

At the same time, high inflation rate diminishes the real value of the wage base for the next categories of pensioners, of current retirees' pensions and value of benefits. Inflation, against the reference currencies, reduced drastically the protection of pension beneficiaries and emphasized their absolute poverty. Furthermore, indexation almost failed to compensate for this risk.

Average old age pension in the Republic of Moldova is the lowest in Europe and covers





***Source:** NSIH*

only 58-60% of subsistence minimum. Thus, those who retire through old age can enjoy only half of their subsistence minimum!?

Average pension accounts for only 26% of national average wage and is the lowest in Europe. According to International Labour Organization, any pensioner in the Republic of Moldova is entitled to a pension of minimum 40% of the national average wage, while the difference is almost two times lower. In 2012 the figure was 28,4%. Estimates show that this rate could drop to 18% by 2050.

The state discriminates the citizen when it establishes a pension, for a 30-year and more contributions period, which is below the subsistence minimum, irrespective of the wage the person received. Any taxpayer's salary was established and promoted by the state; therefore, it cannot avoid the responsibility to provide a proper pension.

If due to the currently established pension, every third pensioner is living on the edge of poverty, then for the age category 70+ years old, 5 out of 10 people are running the risk to live in absolute poverty, most of them being women. Under the conditions of an increase in life expectancy over 70 years old, it is very likely that there are more people that risk living in absolute poverty.

At the same time, current and future retirees face an increased danger of living in poverty at a very old age, correlated with fast devaluation of pensions and underestimated indexation at all ages. Both pension indexations and their calculation formula are obsolete and discriminatory.

Table 2: Poverty rate of the most vulnerable categories by gender aspect, 2008(%).

	Absolute poverty rate		Extreme poverty rate		Absolute poverty rate, total	Extreme poverty rate, total
	Males	Females	Males	Females		
Total poverty rate, %	**27,1**	**25,8**	**3,4**	**3,0**	**26,4**	**3,2**
Poverty rate of the elderly, total, %	**35,3**	**36,7**	**3,2**	**3,3**	**36,1**	**3,3**
By age category:						
60 - 69 years old	28,1	28,0	2,6	2,8	28,0	2,7
70 - 75 years old	**42,4**	**41,1**	2,7	3,1	41,6	2,9
> 75 years old	43,0	49,8	5,1	4,8	47,3	4,9

Source: *Report on achieving Millennium Development Goals, project 7.12.2015*

5. Conclusions and recommendations

The main goal of the pension system is to provide an income to the elderly after the end of their working life. Pension system structure is out of date and fails to achieve the main objective – social protection. Current and future pensioners face a high risk of poverty. Taxpayers are not treated fairly by the system because there are privileges. A consistent link between taxpayers and obligation to pay retirement benefits is required.

- There is no comprehensive state strategy seeking to improve retirees' economic situation and no dialogue between state institutions, pensioners and civil society on indexation;
- Recalculation of pensions established by unitary law, which would redress gaps and omissions, occurred in the calculation of pensions;
- Comprehensive reform of pensions. Adjusting contribution rate for a complete contribution period;
- Pension indexations twice a year or every six months in order to mitigate seasonal price fluctuations of consumer products under the conditions of market economy;
- Adjust pensions to galloping inflation, in order to reduce the risk of pension devaluation over time for pensioners' generations of over 70 years old;
- Review the contributions after 15-year period, for every 5-year threshold by reflecting increases in wages;
- Consistent indexation (a higher coefficient) of pensions below the subsistence minimum, which are based on a complete contributions period for pensions;
- Adjust volume of pensions and indexations to pensioners' life quality standards;
- Promoting fairness and transparency through indexation.

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