

# **ROMANIA:**

## *Considering Options for Extending Social Protection Coverage to Elderly Farmers*

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## **ABBREVIATIONS AND ACRONYMS**

CAP	Common Agricultural Policy
EC	European Commission
ERS	Early Retirement Scheme
ESU	European Size Unit
EU	European Union
GDP	Gross Domestic Product
HBS	Household Budget Survey
IPTS	Institute for Prospective Technological Studies, one of the eight Research Institutes of the EC.
KRUS	(Polish) Agricultural Social Insurance Fund
MARD	Ministry of Agriculture and Rural Development
NRDP	National Rural Development Program
UAA	Utilized Agricultural Area
USDA	United States Department of Agriculture

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## EXECUTIVE SUMMARY

Poverty in Romania is concentrated in rural areas – mainly due to the limited income earned in small scale family farms that are characterized by low productivity. Such farms are not eligible for the European Union’s support schemes for farmers as a result of their small physical and economic size. The current low yields from farming and the lagging poverty indicators in the rural sector are both likely to persist in the medium term. The Romanian government recognizes the current and future problems related to the risk of old-age poverty among elderly farmers and has been working on sustainable solutions to avert this risk. Nonetheless, providing social protection to rural populations poses special challenges.

**Objective:** The main objective of this report is to provide recommendations to the policy makers in Romania in designing a non-contributory program for the poor elderly including farmers. To this end, the report (i) evaluates the current semi-subsistence farming structure and the income situation of farmers in Romania including access to the EU support programs; (ii) provides an overview of the social protection currently available to elderly farmers in Romania through the existing social insurance and social assistance system; and (iii) presents options for a non-contributory scheme for the elderly poor, including farmers, and analyzes the fiscal and poverty impact and the administrative feasibility of each option.

**Subsistence Farming in Romania.** Romania’s farm structure is dominated by low yield/income subsistence and semi-subsistence farming. Small scale subsistence farms account for 99.4% of Romania’s farm holdings. The fact that only a small percentage of subsistence farmers can be integrated into the markets limits their ability to earn income. Due to the small physical and economic size of their land holdings, Romanian farmers do not benefit from the financial support available to farmers in the EU. In terms of ownership, a large share of Romania’s subsistence farms belong to the elderly (44%).

**Welfare Status of Farmers.** Consistent with low productivity subsistence farming, poverty indicators for farmers are less favorable than those for non-farmers. Eight years of sustained economic growth in Romania resulted in a significant decline in poverty. The poverty headcount declined from 28.9 percent in 2002 to 4.4 percent in 2009<sup>1</sup>. Despite the decline in total poverty, the poverty rate among farmers is double the poverty rate among non-farmers, both in 2009 as well as in 2002. In 2009, the poverty rate among farmers was 8.7 percent versus 3.4 percent among non-farmers. Given the predominance of subsistence farming in the agricultural sector, incomes from self consumption accounted for a large share of farmers’ income in 2009, while the share of social protection benefits constituted the second largest share.

**Income Support Schemes for Elderly Farmers and Land Consolidation.** One of the objectives of the Romanian government has been to encourage the consolidation of (semi)-subsistence farms to enable more Romanian farmers to benefit from the CAP support schemes and to increase the competitiveness of the agricultural sector. However, the experience of the Life Annuity Program (Renta Viagera, implemented starting with 2006) did not prove a success in this respect. Out of a targeted population of almost 1.9 million farmers, only 55,000 applications were received. Moreover, the European experience with the Early Retirement Scheme (to be implemented in Romania starting with 2011) raises doubts on its potential effects. A general problem with these types of schemes is that in most cases the farm stays within the family, and as such, structural effects on land consolidation are

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<sup>1</sup> Main decline in poverty in 2009 was due to pension increases as explained later in the text.

limited. In addition, the beneficiaries of the Early Retirement Scheme are supposed to be absorbed into the domestic pension system once they reach the retirement age, which can be a problem if the farmers' contributions to such a system are low, as it is in Romania. These experiences show that it is important to set separate and clear social objectives when designing a benefit program for elderly farmers.

**Challenges of Providing Social Protection to Elderly Farmers in Romania.** The social protection system in Romania consists of social insurance in the form of contributory benefits and social assistance in the form of non-contributory benefits. While the current cohort of elderly farmers is well covered by the social protection system, future generations of farmers are likely to find themselves exposed to increased old-age poverty risk. Most of the current social protection coverage is provided by the social insurance scheme, with 92 percent of the currently elderly farmers being direct beneficiaries of social insurance benefits. Because of their low incomes, the majority of current Romanian farmers of working age cannot afford to participate in the pension scheme as it now requires individuals to pay contributions. This means that today's working age farmers who do not participate in the pension system will not have access to pension income in the future. Over the next 10 years, 450,000 farmers who are now in the 55 to 64 age group will reach retirement age, and about one-third of them will not be covered by the pension system. The social assistance system covers only a small portion of the country's poorest elderly farmers with direct benefits. In 2009, about 24 percent of all of the elderly farmers in the poorest ten percent of population directly benefited from individual or family social assistance benefits. The Guaranteed Minimum Income Program, Romania's main poverty targeted program, covers only about seven percent of the low-income elderly farmers. A previous study (GMI Evaluation Report, 2003) has shown that one of the biggest barriers preventing farmers in benefitting from the GMI program is their land ownership. Many rural elderly farmers who own land above the eligibility limits but are not able to work their land and have no other source of income are not eligible for GMI benefits.

**Choice of the Target Elderly Group.** The analysis finds that there are convincing arguments for a non-contributory benefit for *all* the elderly poor in Romania instead of a categorical benefit directed only to poor elderly *farmers*. First, it is difficult to verify the income of subsistence farmers particularly in the case of elderly as they don't work their land. Second, we find that the cost of covering all elderly poor is not much higher than covering only the elderly poor farmers as an overwhelming majority of the elderly poor live in the rural areas. Furthermore, taking a nationwide approach to cover the entire poor elderly would avoid creating inequities between the urban and rural elderly. Based on the above factors, we recommend that the Romanian Government design a non-contributory benefit program for the entire elderly poor in Romania.

**Key Choices on Program Design and Available Options.** Several fundamental choices need to be made in designing a non-contributory benefit program for the elderly. An important choice is whether the benefit should be integrated with the current means-tested social assistance program (the Guaranteed Minimum Income Program) or whether it should be a universal categorical benefit for the elderly separate from the existing GMI program. The policy makers also need to decide whether they want to introduce an individual or household benefit. Taking these fundamental choices and some design parameters into consideration yields the following three main scenarios: **(a) universal social pension** (an individual benefit) **(b) a targeted means tested social pension** (an individual benefit); and **(c) an extended GMI differential means tested benefit** (family benefit). Within option (b), we analyzed two alternatives **(b1) an individual flat benefit** and **(b2) and individual differential benefit**.

**Cost and Poverty Impact of Options.** Simulations under the perfect implementation of the above scenarios show that the cost of **the universal social pension** (option a above), is the highest (0.1 percent of GDP). **The extended GMI** (option c above) would be the second most expensive (0.026 percent of GDP). **The means tested social pension** with a cost ranging between 0.006 percent of GDP (option b2-differential means tested)) and 0.018 percent of GDP (option b1-flat means tested social pension) would be the lowest cost option. However, if the extended GMI (option c) is chosen the incremental cost to the system would be less than 0.01 percent of GDP since some of the targeted households are already enrolled in the system.

In terms of impact on poverty, the universal benefit (option a), would have the biggest poverty impact taking 85 percent of the poor elderly out of poverty. At the same time, it is the most expensive, costing about 0.1 percent of GDP. The flat means tested social pension (option b1) would have similar poverty impact as the universal social pension, but would cost a fifth (at 0.018 percent of GDP) of the universal scheme. The poverty impact of the extended GMI (option c) is much lower, with about 38 percent of the elderly lifted out of poverty with a lower incremental cost. In order to assess the efficiency of the various options we look at the poverty impact under a constrained budget, by applying the fiscal cost of the extended GMI (option c) to other options. As expected, we find that the poverty impact of the universal social pension drops below the other scenarios, while the outcomes of the other options remain unchanged.

The cost and poverty impact criteria point to the flat means-tested social pension as the most effective and efficient instrument to support the vulnerable poor and to the GMI as the second best since the additional budget needed to expand the scheme would be less than 0.01 percent of GDP. From a poverty impact perspective, the flat means-tested social pension would be the most effective. However, in deciding among these options, policymakers must also take into account the current institutions of the social assistance system and the level of integration of various benefits.

**Administrative Feasibility of Proposed Options.** Both preferred options (option b1-an individual means tested flat benefit and option c-an extended GMI differential means tested benefit) seem equally feasible. However introducing a new benefit in the form of a flat means tested social pension would require more institutional/ administrative capacity at the local level since the new program will have to be administered separately from other programs, and would be likely to increase administrative costs (including the costs of monitoring at the central level for the same reasons). Furthermore, the flat means tested option would be inconsistent with the current objective of the Government to harmonize and simplify eligibility procedures in the social assistance programs in Romania to improve efficiency. Therefore, adding onto the foundation of the existing GMI to cover the poor elderly would be less expensive and would allow for a smoother transition.

**Government's New Reform Program.** The Government of Romania took one step further and has embarked on a comprehensive reform of its social assistance system. The government adopted a Social Assistance Reform Strategy in February 2011. The key rationale for the Government's Strategy is to improve the equity of the social assistance system, reduce its fiscal cost, and simplify the service delivery. In this context, the Government is planning to gradually improve the targeting accuracy of the social assistance system, by changing the program mix, changing the eligibility and benefits parameters of selected programs, and harmonizing the institutional framework. The objective is to gradually move to consolidate all means-tested programs into one larger program for low-income households that will provide adequate support to all poor including the elderly.



# 1. Background and Motivation

1. Romania has a large rural population but the productivity of the agricultural sector is low. There are 9 million people who live in the rural areas representing 43 percent of the total population.<sup>2</sup> In many regions, population density is low with a preponderance of small-scale settlements instead of urban concentrations. The agricultural sector provides employment to 28 percent of the total population, while the share of agriculture in GDP is at 9 percent, indicating low productivity and therefore income.

2. The low productivity of the agricultural sector is mainly due to the dominant share of small-scale family farms. During the period of transition the large-scale operational farming units (agricultural cooperatives and state agricultural companies) were closed down, and in the process, important infrastructure (such as buildings and irrigation facilities) went to rack and ruin. During the transition, farming -regardless of the farm's size and of what technology was used - was the only available income-generating activity available to many families.<sup>3</sup> Thus, a large subsistence and semi-subsistence sector emerged. The slow land restitution process, the legislative environment, the lack of credit institutions, and the only punctual political support (for example, for input subsidies and production premiums) favored the persistence of small and non-market oriented low-productivity farm holdings (Salasan and Fritzsich, 2009). As a result, 99.4 percent of all farms in Romania's agricultural sector continue to be small-scale subsistence family farms. The average size of these 3.9 million farms is only 3.5 hectares, one of the lowest average farm sizes in the EU. The fact that only a small percentage of these subsistence farmers can be integrated into the markets limits their ability to improve income.

3. As a result of their small physical and economic size, Romanian subsistence farms are not eligible for the European Union's support schemes for farmers. According to the Ministry of Agriculture (June 2007), only 1.24 million of Romania's 3.9 million farms were registered in the Farm Register. This means that a large number of farms are currently not eligible to receive single area payments under the EU's Common Agricultural Policy (CAP) since they are not considered as "farms." The minimum condition that has to be met to be registered as a farm is 1 hectare of land, containing parcels of over 0.3 hectares each. This means that the majority of the rural population involved in farming do not benefit from the financial resources available under the EU.

4. Because of the limited incomes earned by farmers, poverty in Romania is concentrated in rural areas. About 74 percent of the poor live in rural areas, and the poverty incidence of the rural population is more than three times higher than that of the urban population. Absolute poverty in

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<sup>2</sup> UN population database

<sup>3</sup> When the agricultural cooperatives were broken up, the land was returned to the people who owned it before the coops were created. These were by definition people who were older. These farms saved people from starvation in the early years of the transition where urban workers would migrate back to the family farms on weekends and help with the farm work and bring back food for the week to the cities when they came back. Given this context, these elderly are reluctant to sell this land which they've only recently been given back and which saved their lives during the early transition. They want to leave the family land to their children.

Romania has decreased dramatically in recent years, from 35.9 percent in 2000 to 4.4 percent in 2009, and the poverty gap decreased from 10 percent in 2000 to 8 percent in 2009. However, while the number of poor people declined by 92 percent in urban areas, it declined by 85 percent in rural areas during the same period, suggesting that poverty reduction is proceeding at a slower pace in rural areas.<sup>4</sup>

5. The current low yields from farming and the lagging poverty indicators in the rural sector are both likely to persist in the medium term. One reason for this is that considerable investments would be necessary for subsistence farms to become commercial and competitive to reach EU standards. Any attempt to modernize the farming methods used in most small farms is likely to be hampered by the lack of access to agricultural credit (Buchenrieder et al.2009). Another reason why it will be difficult to change the farming structure in Romania is that land markets do not function well as in many other post-socialist countries. Among the reasons for this are high transaction costs for buying and selling land (which can reach up to 25 percent of the land's value), the small-scale farm structure in which most land stays in the hands of elderly subsistence farmers, and continuing administrative problems that hinder landowners from being able to register their ownership of the land and to receive formal property titles, which would allow them to use the land as collateral for credit (NRDP, 2009)<sup>5</sup>. Also, experience in the EU-15 has shown that agricultural development has not caused the number of small farms to decline as quickly as expected (von Braun, 2005).<sup>6</sup>

6. In terms of ownership, a large share of subsistence farms belongs to the elderly. The holders of most farm land in Romania are older than 55. In fact, the largest share of these landholders (44 percent) consists of those who have already reached retirement age (65 years old), and most of them are holders of small farm units. In 2007, of the farms that were smaller than two hectares, 41 percent were owned by farmers aged 65 or over, and 64 percent by farmers over the age of 55.

7. Because of their low incomes, the majority of Romanian farmers cannot afford to participate in the current contributory pension scheme. The current pension scheme in Romania requires an individual to pay contributions. The pension reform of 2000 strengthened the link between contributions paid and pensions received and therefore reduced the redistributive aspects of the pension system where higher income participants had been subsidizing benefits for low-income individuals. During the reform process, the farmers' pension scheme was closed to new participants, and pension payments from the old farmers' scheme are now financed by the state budget. Since there are no new entrants, the number of beneficiaries is declining by an average of more than 9 percent every year due to deaths. The reform made the pension system voluntary for farmers since most of them cannot afford the contributions. Currently, hardly any farmers in

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<sup>4</sup> For a similar conclusion, see World Bank (2007).

<sup>5</sup> In order to address the problem, the Government of Romania with the financial support of the World Bank, is launching a national program of systematic land registration in the rural sector.

<sup>6</sup> For example, the average Utilized Agricultural Area (UAA) per farm increased by 80 percent in Estonia, by over 40 percent in Latvia, and by 20 percent in Hungary between 2003 (the year before being admitted to membership of the EU) and 2007. In Romania, the average farm size has slightly increased too, by about 13 percent from 3.11 hectares in 2003 to 3.5 hectares in 2007 (Table 8). A descending trend in the number of farms consisting of less than 2 hectares is also noticeable within the EU-12. Hence, between 2003 and 2007, the number of farms consisting of less than 2 hectares dropped by 15 percent but with a wide variation among countries (Hubbard, 2009).

Romania are making pension contributions. This means that those farmers who have opted out of participating in the existing pension scheme will not receive a pension income in the future and will therefore need other forms of social protection.

8. Several characteristics of the population involved in farming make social protection outreach difficult. For example, it is difficult to verify the income of subsistence farmers, which is necessary in contributory schemes where the contributions are earnings related. However, non-contributory programs present special challenges as well. Non-contributory systems designed to fight poverty tend to be non-categorical, meaning that they are available to all poor households, not just the elderly poor. In many middle-income countries, non-contributory systems use means tests to assign their benefits, but this once again requires the verification of income involving the same difficulties. The income of subsistence farmers can in theory be imputed based on the land or livestock owned by the household. However, in the case of elderly, who cannot work the land that they own, this can result in an overestimation of their true income and thus to their exclusion from the program.

9. These challenges are causing concern about the social protection coverage of elderly farmers in Romania. While the current cohort of elderly farmers is relatively well covered by the social protection system, about 40 percent of non-elderly farmers belong to the poorest segment of the population. The phasing-out of the existing farmers' pension scheme, the lack of participation by working-age farmers in the pension scheme and the demographic aging of the population together mean that there will be a large cohort of farmers who will be unprotected in the future. The Romanian government recognizes the current and future problems related to the social protection coverage of the elderly farmers and has been working on improving their social protection. The first measure, introduced in 2009, significantly increased the current farmers' pension (which is paid to the beneficiaries of former agricultural cooperative members) up to the new minimum pension level of 350 RON/month. The second initiative consists of new legislation introducing a separate mandatory contributory pension scheme for farmers. This new law was issued with an effectiveness date of January 1, 2010 but has been postponed by one year while the government considers its cost implications. Finally, the government is considering introducing a non-contributory benefit for the elderly poor (including farmers). The details of this non-contributory program are yet to be decided, with two main options being currently considered: (i) to enhance the existing last-resort income support program (the Guaranteed Minimum Income, or GMI) by designing a specific component for elderly or (ii) to introduce a zero pillar or social pension - non-contributory cash income given to older people.

10. Against this backdrop, this report evaluates the farm structure and incomes available to farmers in Romania. It evaluates the coverage and level of social protection benefits available to farmers, with a focus on poor elderly (farmers) and makes some recommendations on the best way to design the proposed non-contributory program for the elderly poor including farmers. The paper is structured as follows. In Section 2, we present the current semi-subsistence farming structure and the income situation of farmers in Romania. In Section 3, we give an overview of the social protection currently available to elderly farmers in Romania through the existing social insurance and social assistance system. In Section 4, we list the available options for a non-contributory scheme for the elderly poor, including farmers, and present the fiscal and poverty impact and the administrative feasibility of each option. In Section 5, we present our conclusions with recommendations.

## 2. Subsistence Farming and the Incomes of Farmers in Romania

Romania's farm structure is dominated by low yield/income subsistence and semi-subsistence farming. Elderly farmers account for a large share of all farmers and are mostly found in the small farm units. Due to the small physical and economic size of their land holdings, Romanian farmers, including the elderly, do not benefit from the financial support available to farmers in the EU. Consistent with the low productivity subsistence farming, poverty indicators for farmers are less favorable than those for non-farmers. Social protection benefits (pensions) constitute a big share of household income for farm households. Consequently, farmers who do not receive social protection benefits are poorer than the beneficiary farmers. In terms of ownership, a large share of subsistence farms belong to the elderly, and this share can be expected to increase as the Romanian population ages.

### 2.1. Definitions and Size of (Semi)-Subsistence Farming

11. There is no specific definition of a farmer within the EU. The European Commission (EC) gives the Member States broad room to maneuver in defining their farms and farmers. Particularly within Pillar 2 of CAP, the EU Member States use a range of different definitions. Romania itself has adopted several definitions of farms. In the context of rural development measures, for example, the government has introduced a farm size threshold of 2 European Size Units (ESU),<sup>7</sup> with 1 ESU roughly corresponding to 2 hectares of wheat and 1 dairy cow.

12. Also, there is no agreed definition of subsistence or semi-subsistence farming in the EU. According to a definition adapted from Martins (2009), subsistence farms are those that produce (almost entirely) only for their own consumption. Regulation EC/1698/2005 defines semi-subsistence farms as agricultural holdings that produce primarily for their own consumption but also market a proportion of their output. Criteria such as the farm's physical size, its economic size, and the extent of its market participation are crucial to distinguish (semi-) subsistence farms from commercial farms (Buchenrieder et al, 2009). However, these definitions give no thresholds with respect to output sales (or any other indicators) to distinguish between subsistence and commercial farms. Annex II of Regulation EC/1974/2006 advises the Member States that a precise definition should take into account the minimum and/or maximum size of the farm, the proportion of its production marketed, and/or the level of income of the farm. For practical purposes, the EC defines subsistence farms as being smaller than 1 ESU.

13. Therefore, Romania, like other EU Member States, defines national thresholds to identify subsistence and semi-subsistence farms. These are simple size indicators instead of self-consumption shares. The chosen thresholds are to some degree arbitrary, and the boundaries between subsistence, semi-subsistence, and commercial farming remain hard to draw (Ramniceanu, 2004). In Romania, for the purposes of NRDP implementation semi-subsistence farms have been defined as holdings whose economic size ranges between 2 and 8 ESU (MARD), 2008 and NRDP, 2008).<sup>8</sup> Within a tender commissioned by the EC's Institute for Prospective

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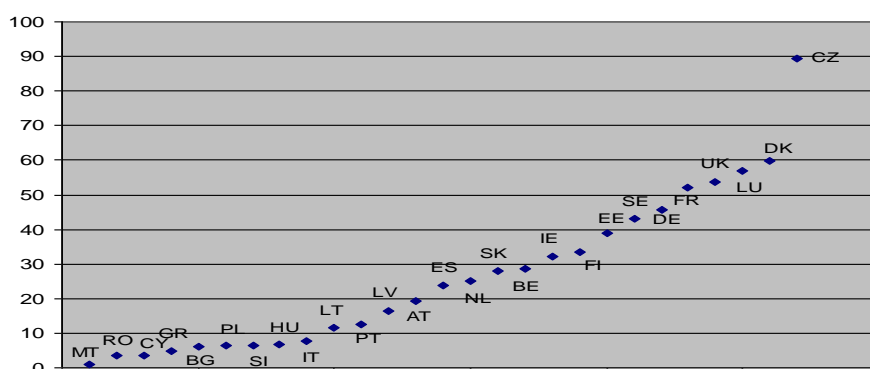
<sup>7</sup> One ESU is equal to 1,200 EUR standard gross margin. The ESU is a measure of the economic size of land holdings based on the gross margin imputed from standard coefficients.

<sup>8</sup> Within the new Member states of the EU, Bulgaria, Poland and Romania in particular have a significant number of smaller farms. Bulgaria uses a threshold of 1 ESU for differentiating between subsistence and semi-subsistence farms; the maximum threshold for being considered as semi-subsistence farm in Bulgaria is 4 ESU. To be eligible for the semi-subsistence measure (Measure 141), Bulgarian farms have to fulfill additional criteria such as having at least 0.5 hectares of

Technological Studies (IPTS),<sup>9</sup> semi-subsistence farms in Romania were defined as farms between 1 and 4 ESU. This definition was agreed on between the IPTS and Romanian experts in the field (Fritzscht et al, 2008). These multiple definitions emphasize the lack of agreement on the definitions of subsistence and semi-subsistence farmers in Romania.

14. Based on the definitions discussed above, Romania’s farm structure is dominated by low yield subsistence and semi-subsistence farming. As discussed in Section 1, Romania has one of the lowest average farm sizes in the EU (Figure 1). The number of farms categorized as subsistence farms account for 94 percent of Romania’s farms (Table 1). Overall, subsistence and semi-subsistence farms account for 99.4 percent of Romania’s farms.<sup>10</sup> The share of the utilized agricultural area (UAA) accounted for by the low yield subsistence and semi-subsistence farmers is 62 percent, while the remaining 38 percent is used by commercial farms (including large-scale corporate farms). In addition, according to the latest available Eurostat data (2005), 90 percent of these small-scale farmers have no formal training in agriculture. As a result of these factors, the agricultural sector is characterized by low productivity, accounting for only 9 percent of GDP while providing employment for 28 percent of the population.

**Figure 1: Average Farm Size in the EU-27, 2007 (UAA ha/farm)**



Source: Own calculation based on Eurostat.

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their agricultural land in mountainous, less favored areas and/or 0.5 hectares in permanent crops including vineyards and/or 1 ha in other areas (RDP-BG, 2009, p. 17 /p. 134). In Poland, the agricultural production value has to be within the range of 2 to 4 ESU (RDP-PL 2005).

<sup>9</sup> The Institute for Prospective Technological Studies (IPTS) is one of the seven scientific institutes of the European Commission's Joint Research Centre (JRC).

<sup>10</sup> One might argue that the smallest farms of less than 1 ESU (overall, there are 3,064,670 subsistence farms smaller 1 ESU) are not real farms in the sense that they are subsistence-oriented and not commercial and therefore should be excluded from the statistics. This is done implicitly in Romania by excluding these holdings from farm registration.

**Table 1: Distribution of Farms in Romania According to their Size in 2007**

Importance of	Farm classification	Number of farms	Share in total number of farms percent	Share in UAA percent
Subsistence farms	< 1 ESU	3,064,670	77.95	30.94
	< 2 ESU	3,694,470	93.97	48.97
	> 2 ESU < 8 ESU	212,880	5.41	13.30
Commercial farms (including large scale corporate farms )	> 8 ESU	24,000	0.61	37.73
Total number of farms		3,931,350	100.00	100.00

Source: Own calculation based on Eurostat data (2010)

## 2.2. Available Incomes from the EU Support Policies and Eligibility of Semi-(subsistence) Farmers

15. Considerable financial support is available to farmers in the EU in the form of agricultural and rural measures within the CAP. Support through the CAP accounts for around 40 percent of the EU's budget and covers a wide range of expenditures.<sup>11</sup> Originally, most agricultural support was provided to the industry indirectly through market measures. Since the CAP reforms of the mid 1990s, there has been a shift towards providing direct support (under Pillar 1), which became decoupled from production.<sup>12</sup> All in all, 13.5 billion Euro are made available to support Romania's farming sector from the EU in the period 2007-2013.

16. The majority of the rural population, including the elderly, who are involved in farming do not benefit from the financial resources available under the EU support schemes due to the small physical and economic size of their landholdings. According to the Ministry of Agriculture (June 2007), out of the total number of farm households in Romania, only 1.24 million (29 percent of the total) were registered in the Farm Register. To be registered, farms have to consist of a minimum of 1 hectare of land, with parcels over 0.3 hectares. This means that more than 2.5 million small household holdings are currently not considered as "farms" and are therefore not eligible for farm support under the Common Agricultural Policy (CAP). Since a large share of these subsistence farmers consist of the elderly (Table 2), it means that majority of the elderly do not benefit from EU support. The holders of farm land in Romania are mostly above age 55. (Table 2) In fact, the biggest share is the persons who already have reached retirement age. Farmers over 65 years old account for 44 percent of all farmers. When looking at the farm size categories, elderly holders are mostly found in the small farm units. In 2007, of the farms that are smaller than 2 hectares, 41 percent were owned by farmers above age 65 and 64 percent were owned by farmers above age 55 (Table 2).

<sup>11</sup>Support through CAP is divided in two packages, referred to as Pillar 1 and Pillar 2.

<sup>12</sup>The decoupled payment scheme was introduced under Pillar 1. Expenditure under the Rural Development Regulation is referred to as Pillar 2, the second and growing side of CAP.

**Table 2: Farm Owners in Romania by Age and Farm Size Measured as ESU and Utilized Agricultural Area (2007) in percent**

Age (years)	Farm size					
	ESU: 0-2	2-8	8-40	40-100	Over 100	Total
< 35	5.43	3.92	7.76	6.00	5.08	5.32
35-54	29.77	28.89	47.85	60.60	61.03	29.84
55-64	21.93	25.54	23.25	24.71	27.03	22.25
>=65	42.87	41.64	21.13	8.69	6.86	42.60
	UAA: < 2 ha	2 ha to < 5 ha	5 ha to < 50 ha	50 ha < 100 ha	>= 100 ha	Total
< 35	4.93	3.04	2.85	8.44	6.42	4.26
35-54	31.33	22.68	23.99	52.74	60.66	28.52
55-64	22.53	22.40	23.73	22.36	26.71	22.62
>=65	41.22	51.88	49.43	16.67	6.21	44.60

Source: Own calculation based on Eurostat data for 2007.

Note: According to the Romanian definition, subsistence farms are those smaller than 2 ESU. Their average surface was 1.8 hectares Utilized Agricultural Area in 2007.

17. The government's strategy for activating the land market and therefore land consolidation has had only limited success. One of the objectives of the Romanian government has been to encourage the consolidation of (semi)-subsistence farms to enable more Romanian farmers to benefit from the CAP support schemes and to increase the competitiveness of the agricultural sector. To achieve this objective, the National Development Program (2007-2013) includes a support program (*Renta Viagera-Life Annuity Program*) to encourage elderly farmers to sell or rent their land since elderly farmers are unlikely to use the land efficiently. As discussed above, the majority of the subsistence farms belong to the elderly who are traditionally unlikely to sell their land as land ownership is considered a form of security that they can rely on in case of hardship. Therefore, the program offers lifelong annual per hectare payments of Euro 50 for leasing and Euro 100 for selling land with the aim of encouraging elderly farmers to retire early and to sell or lease their agricultural holdings to younger farmers who are likely to be more innovative and to have more entrepreneurial skills. However, the outcomes of this early retirement initiative have been less than desired. Out of a targeted population of almost 1.9 million farmers, only 55,000 applications were received. As of March 2008, 85 percent of the beneficiaries had chosen to lease their land while only 15 percent had chosen to sell (Ghib, 2008). The reasons for this seem to be that: (i) the subsidy was not high enough to make the program attractive; (ii) insufficient money was budgeted to promote the program successfully; (iii) many farmers still do not have clear title to their land (iv) the program's rules were too complex; and (v) there were high transaction costs associated with the selling option (Alexandri and Luca 2008, Diaconu, 2007, and Ghib 2008). There were no new beneficiaries of the Life Annuity Program after 2009. Among the reasons why the Life Annuity Program was not successful is that the Program included many variables (including administrative capacity) with each individual variable contributing to the complexity of the program. Therefore, it is important to set separate and clear social objectives when designing a benefit program for elderly farmers.

18. According to the NRDP 2009, an Early Retirement Scheme (ERS) is to be implemented after the finalization of the national pension legislation in 2010. The objective of the ERS, similar to the Life Annuity Program is land consolidation. The difference is that the target group of the ERS is to provide support to farmers between age 55 and below retirement age. The success of the early retirement measure is difficult to assess especially due to deadweight losses that occur *if changes following the introduction of an ERS would have happened anyway* (Fellmann and

Möllers 2009 and Caskie et al, 2008). There is some evidence of some farms being transferred, but the number of assisted transfer is small and the overall impact is therefore also small (Agrar CAES, 2005 and Fellmann and Möllers, 2009). With regard to structural objectives, Caskie et al (2008) believe that it is not possible to increase the profitability of farms simply by replacing older farmers by younger farmers. Also, the cost-effectiveness of this kind of scheme is questionable. In the last EU program period 2000-2006, early retirement schemes were introduced in seven of the EU-15 countries (Germany, Greece, Ireland, Spain, France, Italy, and Portugal). Between 2004 and 2006, the EU-10 could also offer this measure (e.g. Poland made this choice). In the period 2007-2013, the measure will be offered by 17 Member States. As the European regulations give the Member States authority over how the national schemes are designed, they vary from country to country. Experience in Ireland, which has a similar farm structure to that of Romania characterized by small farms and a low level of land mobility, has shown only limited success (see Annex 2). In addition, there are indications that the program does not reach the least developed regions (e.g. in Ireland and Spain) although the main incentive to take part is a pension income that is higher than the current farm income. A general problem is that in most cases the farm stays within the family and structural effects are limited.

### **2.3. Subsistence Farming and Income Structure of Farmers: Definitions Used for the Purpose of this Analysis**

19. For the purposes of this analysis, a farmer is defined as an individual who is either self-employed in agriculture or a member of a farming association. Data constraints limited our ability to analyze the characteristics of farmers on the basis of the ESU definition of farm sizes discussed above. The main source of information that was available to us to analyze the characteristics of Romanian farmers was the Household Budget Survey (HBS) data from 2009.<sup>13</sup> According to this data set, there are 2.61 million farmers in Romania according to our definition. This is equivalent to 14 percent of the population aged 15 and over.

20. Currently, there are about 646,000 elderly farmers in Romania or 25 percent of the total farmers, but this number and proportion can be expected to increase in the future as the Romanian population ages as life expectancy increases.<sup>14</sup> The aging of Romania's population is captured in the old age dependency ratio (the population aged 65 and higher divided by the population between

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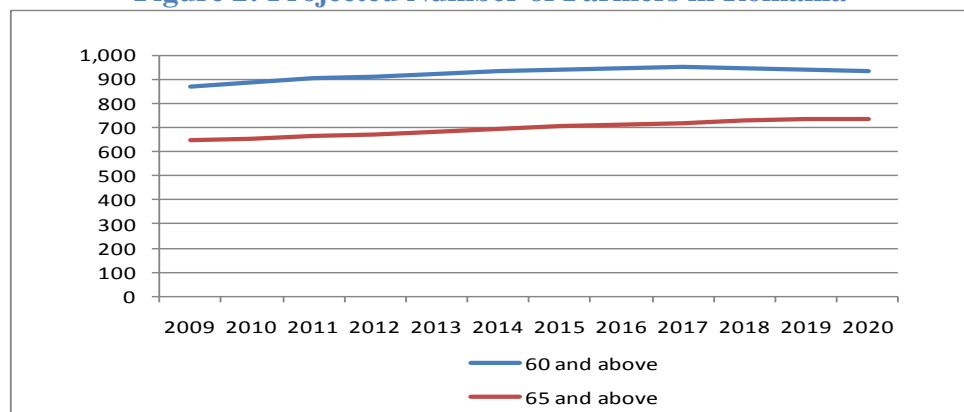
<sup>13</sup> The data used for analysis in this note are from the Romania Household Budget Survey. The main constraint of this dataset is that it does not include any information about land or livestock and their use. The only information that can be used is in the sections on employment and activity (what type of work the individual performed in the reference month), though we explored and discarded several other approaches. In one definition, all households who declared that they had made a positive income from farming were considered to be farmer households, but this definition was too restrictive as most of the rural households in Romania practice subsistence agriculture and do not sell any agri products. In addition, because the survey data used for our analysis were the result of 12 monthly waves of data collection, many farmers' households could have been excluded because of the seasonality of their sales. Likewise, another definition that we explored was to include households that reported the positive value of their own food production. This was rejected because some households might have a positive value of own food production even if farming was not the principal activity of the income earners in the household. The definition that we finally chose, based on activity in the reference month, is probably affected to some extent by both inclusion and exclusion errors – in other words, some individuals who work other people's land were considered as being farmers (inclusion error), while some individuals/ households surveyed outside the “farming season” were excluded because of an apparent lack of farming activity. However, we believe that these errors did not significantly affect the estimations presented in the note, and we believe that the definition that we used is as being the most appropriate one under the current data constraints.

<sup>14</sup>This number is very close to the number of old age farmer pensioners, which is 672,000 in January 2010. The difference is most likely due to the fact that there are old age farmer pensioners who are younger than 65.



the ages of 15 and 64), which is projected to rise from 23.6 percent to 56.6 percent by 2050. It is reasonable to expect that farmers will also be affected by the demographic aging process. Projections indicate that the number of farmers above the age of 65 is projected to increase from 646,000 to 738,000 during 2009 and 2020, while the number of farmers above the age of 60 is projected to increase from 872,000 to 932,000 during the same period.<sup>15</sup>

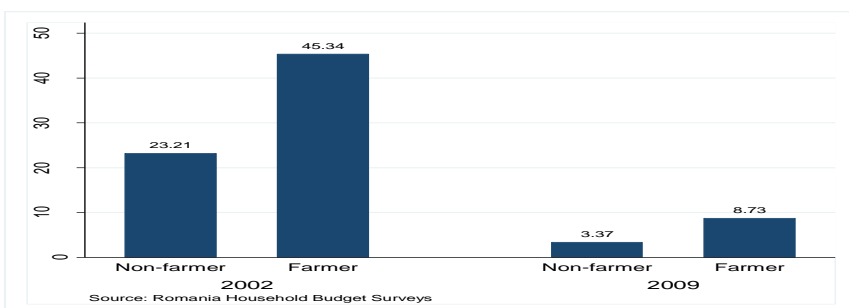
**Figure 2: Projected Number of Farmers in Romania**



Source: Authors' calculations based on HBS data

21. Consistent with the large share of low productivity subsistence farming in the agriculture sector, the poverty indicators for farmers are less favorable than those for non-farmers. Eight years of sustained economic growth in Romania resulted in a significant decline in poverty. The total poverty rate went down from 28.9 percent in 2002 to 5.7 percent in 2008. The decline in the poverty rate continued in 2009 despite the global economic slowdown and went down to 4.4 percent.<sup>16</sup> Despite the decline in total poverty, the poverty rate among farmers (the vast majority of whom live in rural areas) was double of the poverty rate among non-farmers in 2009 – 8.7 versus 3.4 percent – a ratio that has not changed since 2002 (Figure 3). This means of the 2.61 million farmers, 227 thousand were poor in 2009. Out of them about 40 thousands were elderly.

**Figure 3: Poverty Rates for Farmers and Non-farmers (Population aged 15 and over)**



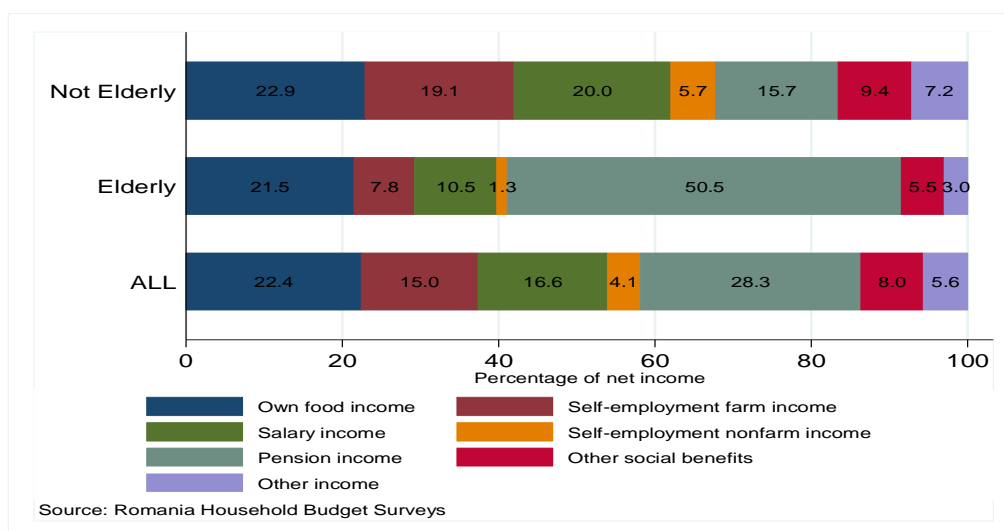
Source: HBS data

<sup>15</sup> Rough results based on the data from HBS on the age and gender distribution of farmers in 2009. Mortality rates of the overall population were used since specific mortality rates for farmers were not available.

<sup>16</sup> The decline in poverty despite the economic downturn is attributed to the sizable increases in pensions. Given its extensive coverage, the increases in pensions potentially acted as a way to mitigate the negative income shock for poor households. However, these gains, which could have been achieved more efficiently, came at a cost through affecting the fiscal sustainability of the pension system. (Technical Notes on Recent Trends in Romania, World Bank 2010)

22. As might be expected given the predominance of subsistence farming in the agriculture sector, self-consumption accounted for a large share of farmers' income. In 2009, incomes from farming (own food income and self employment farm income), accounted for 37 percent of farmers' total household income. Own food consumption accounted for 62 percent of income from farming activities, while social protection benefits (pensions and other social benefits) constituted the second largest component of farming households' income (almost 36 percent in 2009).<sup>17</sup> The share of social protection benefits in farmer households' income has increased significantly between 2002 and 2009.

**Figure 4: Components of Total Income of Farmer Households**



Source: HBS data

23. Social protection benefits are the main source of income for those households that contain an elderly farmer – representing more than half of their total income in 2009. The share of pension benefits in total household income in elderly farmers' households increased from 34 percent in 2002 to 51 percent in 2009. The share of social protection benefits (pension and other social benefits) in total income also increased - from 21 percent in 2002 to 25 percent in 2009 - for non-elderly farm households (Figure 4). For both elderly and non-elderly farmer households, pension benefits constitute the majority of income received from the social protection system, mainly because of the minimum pension introduced in 2009 (currently at the level of RON 350/month), which constituted a sizable increase for most pensioners. Of the 745 thousand farmer pensioners in May 2010, 433 thousand received a minimum pension. For some of these pensioners, the minimum pension represents eight times the pension that they would be eligible for based on the contributions that they paid.

24. Farmers who do not receive social protection benefits are poorer than the beneficiary farmers. Of the total 1,007 thousand beneficiary farmers in 2009, 29.2 thousand were poor, indicating a poverty rate of 2.9 percent. Given that the non-beneficiary farmers receive no social protection benefits, a larger share of the non-beneficiary farmers are poor. Of the 1,611 thousand

<sup>17</sup> The share of own food consumption in total household income went up significantly once we excluded the social protection benefits.

non-beneficiary farmers, 198 thousand are poor, with a poverty rate of 12.3 percent. This means that the poverty rate among non-beneficiary farmers is more than four times the poverty rate among the farmers who receive benefits from social protection programs.

### 3. Social Protection for Farmers

Several characteristics of the rural population in general make the social protection outreach difficult. These challenges raise a concern on the social protection coverage (through contributory or non-contributory programs) of the rural population including elderly farmers. As a result of these challenges, policymakers typically face a number of choices in designing pension systems for farmers.

#### 3.1. Framework for Social Protection of the Elderly Farmers

25. Providing pensions to farmers poses a number of issues, some of which are also overall coverage issues but others are unique to farmers. Like other self-employed workers, farmers often have low incomes that are seasonally volatile, and they often suffer from low liquidity since much of their business can be conducted in goods and in kind. Also, like other self-employed workers, their incomes are hard to measure, making it difficult to verify their social protection contributions, which are typically based on income levels. In the case of farmers, not only is their income hard to verify but, because they consume some of what they produce, less of their income is monetized, making it even more difficult to measure. They also suffer from income volatility from year to year since their harvests depend on fluctuating weather conditions. Because they are geographically more dispersed than urban dwellers, the collection, enforcement, and even service delivery for social protection programs is more difficult. However, unlike the rest of the poor, farmers typically have political clout.

26. As a result of these differences, policymakers typically face a number of choices in designing pension systems for farmers (Figure 5). First, they need to decide whether to have a separate system or whether to have a system that is integrated with either the normal pension system or the social assistance system. Then they need to decide whether they want to provide a subsidy to farmers and to which groups within the farming community they want to provide the subsidy. Finally, they need to decide the nature of that subsidy.

#### *Separate or Integrated*

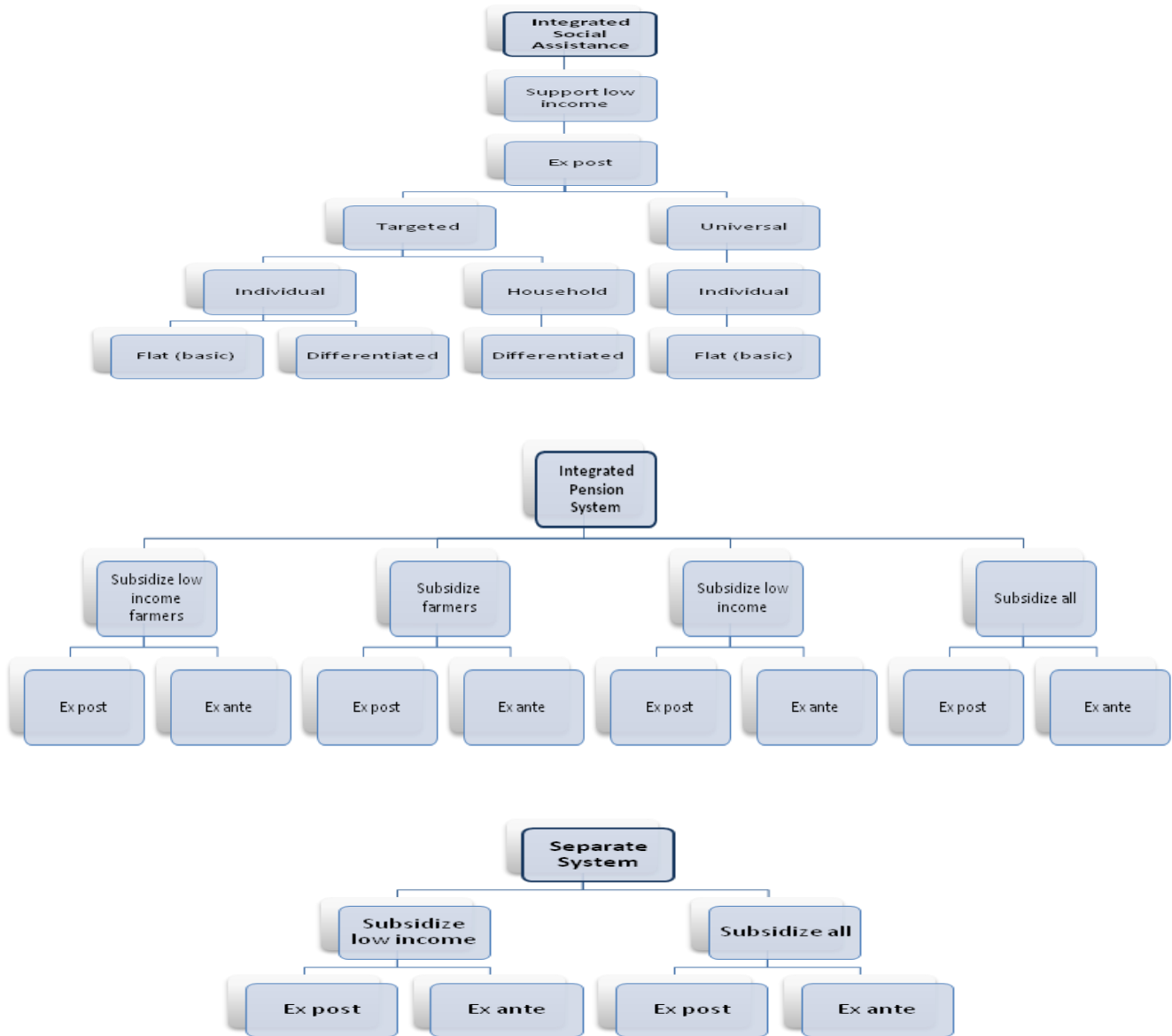
27. Some countries, including Poland and Albania, have opted for separate pension systems for farmers (see Box 2).<sup>18</sup> The advantages of these separate systems is that most of them require

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<sup>18</sup> Among the member states of the EU, Austria, Finland, France, Germany, Greece, Italy, Luxembourg, Poland, and Spain have opted for separate pension systems for farmers (Mehl, 2005). All of these schemes face a similar problem, which is the deteriorating system dependency ratio (the ratio of people receiving pensions from a certain pension scheme divided by the number of workers contributing to the same scheme in the same period). Even if some of these schemes are relatively well functioning models, they still rely on government transfers to a considerable extent. For example, in Austria, the social insurance system for farmers is considered to be a well functioning model since major institutional changes were made to the scheme during recent years. However, the government still pays for 34 percent of the total contributions on behalf of the relatively wealthier farmers. Of the total 22.8 percent contribution, 15 percent is paid by the farmer and the remaining 7.8

flat contributions from each farmer (sometimes differentiating by size of land and geographical location but sometimes not), which avoids the need to measure income. Similarly, benefits can be tailored to take into account own consumption and limited cash requirements for housing which reduces a rural family’s cash needs compared with, for example, an urban pensioner who has to pay for both housing and food.

**Figure 5: Framework for Social Protection of Elderly Farmers**



percent is covered by the state. Low-income farmers (those with annual incomes of less than Euro 15,000) are not required to pay the 15 percent and get a full subsidy from the state budget.

## **Box1: Pension Scheme for Farmers (KRUS) in Poland**

**Poland has a separate pension scheme for farmers.** There are two main mandatory pension schemes in Poland. The first one is KRUS that provides pension benefits for farmer and the second one is ZUS that provides pension benefits for all other workers and the self-employed. KRUS offers pay-as-you-go financed, defined benefit pensions to nearly 1.45 million people (as of 2008) and collects contributions from and on behalf of almost 1.57 million farmers and their family members KRUS and is supervised by the Ministry of Agriculture and Rural Development.. The organizational structure comprises a head office, 16 regional and 256 local offices as well as 7 rehabilitation centers. The overall staffing level was 6,500 persons in 2005 (Fitzpatrick 2005). Farmers have their voice through the Council of Farmers' Social Insurance. This Council consists of 25 members appointed by farmers' organizations for three years. They not only have control rights in terms of the appointment of the KRUS president but also supervise the Contribution Fund.

**KRUS was not included in the major reforms which the Polish pension system underwent in 1999..** Similar to the pension systems of the other transition economies, the Polish pension system was strained by the country's transition to a market economy characterized by massive restructuring and a significant drop in formal sector employment. Revenues declined as formal sector employment fell; expenditure rose as a result of low retirement ages, early retirement provisions in many sectors, and relatively generous benefits, creating pension system fiscal deficits. The deficits were projected to worsen over time under the projected aging of the Polish population. Following a long debate, in 1999 the Polish government introduced a new multi-pillar pension system. The traditional pay-as-you-go system inherited from the socialist times was replaced with a multi-pillar pension system that included a notional defined contribution (NDC) scheme and a mandatory fully funded defined contribution scheme. These reforms significantly improved the fiscal balance of the pension system. Following the 1999 reform, Poland continued reforms to address the remaining issues. These reforms placed Poland in a better situation than the rest of the neighboring countries that also introduced major reforms. While most of the neighboring countries felt the pressure to introduce changes to certain pension system parameters with the impact of the financial crisis, Poland managed to keep the existing parameters intact. KRUS was left out of the original reforms in 1999 The traditionally powerful agricultural lobby also has some impact on this outcome. There has been broad agreement within successive Polish governments that KRUS needs to be reformed in order to improve its financial sustainability but no government has managed to take any reforms steps yet.

**Majority of KRUS expenditures are financed by the state budget.** The parameters of the ZUS and KRUS pension systems differ significantly with KRUS offering access to public health care, old-age and disability pensions, and accident and maternity benefits at a much lower premium than ZUS. Monthly contribution to KRUS in 2008 was about 7.5 times lower than the minimum monthly contribution paid by ZUS members. (The quarterly flat rate contributions were the following in the third quarter of 2009: for accident, sickness and maternity 90 PLN (~ 33USD) and for pensions insurance: 203 PLN (~ 75USD). Farmers who have an additional non-farm activity had to pay 586 PLN (~ 216USD) per quarter) As a result, KRUS revenues only cover a small part of its expenditures, with the shortfall being financed by budget transfers. In 2008, budget subsidies financed 88.5% of expenditures. Income related payments were discussed in Poland but it seems that such an approach is not acceptable or workable in Poland although the current state contribution in the program is very high. One key issue would be not only to clearly identify farmer's potential earnings (e.g. based on farm size) but also their capacity to pay (Fitzpatrick 2005). The collection of data for this should be practicable and cost-effective.

**Eligibility rules for KRUS are not clearly defined and many people owning land or are related to farmers have the de facto option to choose between ZUS and KRUS.** To be eligible for insurance by KRUS, one has to be a farmer or family member in a farmer's household. Insurance through KRUS is obligatory for farmers. The definition of farmers is based on the following eligibility criteria that the person has to fulfill: (1) conducting an agricultural activity on his/her own account as the owner of the farm situated in the Republic of Poland; and (2) being the owner of a farm of a minimum size of more than one hectare of arable land or a special agricultural production. Further persons that are eligible for KRUS benefits are (a) a farmer's spouse who works constantly on the farm, in the special section of agricultural production or keeps the house which is directly connected with a farm; and (b) other farm household members - if those persons are not covered by other social insurance - who are over 16 years old, live in a shared household with a farmer or lives on the farm or in the neighborhood and work constantly on the farm of the farm household and is not employed by a farmer as a worker. The exception to this rule are those who conduct agricultural activity or work on the farm and at the same time conduct non-agricultural economic activity or cooperate in conducting such activity. According to the Law of 1 January 1997, these persons may choose the system by which they want to be covered. Voluntary insurance is possible among others for subsistence farmers who work on farms of less than 1 hectare area.

28. On the other hand, a separate system makes it difficult to accommodate individuals who generate income from both agriculture and non-agricultural activities, particularly those who change from agricultural work to non-agricultural work in the course of their working lives. Countries with separate systems have also found that, because farmers have political clout, policymakers face pressure to raise the minimum farmers' pension to the same level as that of their urban counterparts, regardless of whether the same circumstances actually apply. Finally, both the farming population and the urban population contain individuals with a range of income levels. Higher-income farmers could afford to pay the same level of contributions as urban residents and receive urban-level pensions, whereas lower-income urban workers face many of the same constraints as lower-income farmers. Therefore, creating a separate program for farmers' pensions would leave urban low-income workers with no similar affordable program.

29. A third option might be to integrate the farmers' pension system with the social assistance system in recognition of its subsidized nature. In this case, all elderly farmers falling below a certain income threshold would receive a top-up cash benefit. The advantages of this would be that the subsidy would only go to those who needed it, which would allow the state to transfer its limited resources to those in the greatest need regardless of their age or previous work history. The disadvantage of this option would be that pensioner incomes do not vary as much as the incomes of households with working age members. Typically once a pensioner is poor, the pensioner will be poor throughout the remainder of his or her life. While this may be less true of farmer pensioners than ordinary pensioners, it still means that means testing, which is usually carried out once or twice a year in most social assistance systems, would be unnecessary and potentially wasteful. Farmers who have paid contributions often resist this option because they find the means testing demeaning, but it is an option that policymakers should consider.

### ***Targeting versus a Universal Subsidy***

30. The second choice that policymakers need to make is whether to provide the subsidy to all retirees or only to the poor. If the system is integrated with the social assistance system, it will automatically provide assistance only to the poor. In the case of a separate system, subsidies could either be provided to all farmers or only to poor farmers. If integrated with the overall pension system, subsidies could be provided to everyone, to all farmers, to all low-income retirees, or only to low-income farmers.

31. Universal subsidies are easier to administer than targeted subsidies and thus entail lower administrative costs. However, the advantage of targeting is that it means that the state's limited resources are spent only on those who need it.

32. An alternative would be to allow individual farmers to self-select by providing full unsubsidized benefits to those who choose to contribute to the national pension scheme while providing substantially lower benefits (possibly through the social assistance scheme) to those who are unwilling or unable to contribute to the national scheme. Self-selection avoids the costs and headaches of trying to collect contributions from reluctant contributors and of maintaining records for them, and absolves the government from having to pay the same level of benefits as it pays to contributors to people who did not make comparable contributions.

## ***The Nature of the Subsidy***

33. The government can provide the subsidy in one of two different ways. It can provide it *ex ante* as matching contributions to the contributions made by the potential retiree or can be provided *ex post* at retirement in the form of either a social pension or a minimum pension. In general, the *ex ante* approach has the benefit of giving workers an incentive to contribute since they only get the government's matching contribution if they do so. The *ex post* approach provides no such incentive because it guarantees a minimum pension that is typically unrelated to contributions. However, the *ex post* pension, if means tested, might be cheaper to provide because payments are only made to retirees below an income threshold. However, means testing requires the assessment of income, which is especially difficult to do in rural areas. This is because incomes from agriculture are difficult to assess, especially when households practice subsistence agriculture. In such cases the incomes are imputed based on land or livestock owned by the household. However, while in the case of households with able-bodied adults (who could work), this approach leads to a reliable estimate of "incomes", in the case of elderly, who cannot work the land, the inclusion of land size in the computation of income can lead to an overestimation of their true income and thus to their exclusion from the program. If the *ex ante* approach were to be targeted, it would introduce disincentives for individuals to earn or report any earnings above the threshold.

34. While these are general observations, when applied to farmers specifically, there can be additional disadvantages in using the *ex ante* approach. One of the major arguments for setting up special provisions for farmers is that they suffer from annual weather-related variations in their income. Using an *ex ante* approach makes the government's intervention procyclical, instead of countercyclical. In other words, in years when weather is unfavorable and individuals are unable to contribute because of their limited income, the government's contribution would be withdrawn as well, thus magnifying the impact of the weather-related income shock. Given a potential mix of good and bad years over a farmer's career, if the government's subsidy was targeted and provided *ex post*, then this would insure that the subsidy went to those who have not been able to save enough for retirement over their entire career.

### **3.2. Social Protection and Elderly Farmers in Romania**

35. The social protection system in Romania consists of social insurance in the form of contributory benefits and social assistance in the form of non-contributory benefits. Social insurance includes pensions for former employees or farmers (for old age and disability) and their dependents (survivors), as well as unemployment benefits.<sup>19</sup> The social assistance system includes a number of cash and in-kind benefits and services that cover children and families, disability and illness, allowances for housing utilities, merit-based benefits such as allowances for war veterans, and last-resort income support program -Guaranteed Minimum Income (GMI). Overall, total spending on social protection was 10 percent of GDP in 2009, most of which was allocated to social insurance (about 8 percent of GDP), including pensions. There are 35 social assistance programs, comprising a mixture of categorical, income/means-tested, and "merit-based" schemes. Spending on social insurance averaged about 5.8 percent of GDP between 2002 and 2007. With the

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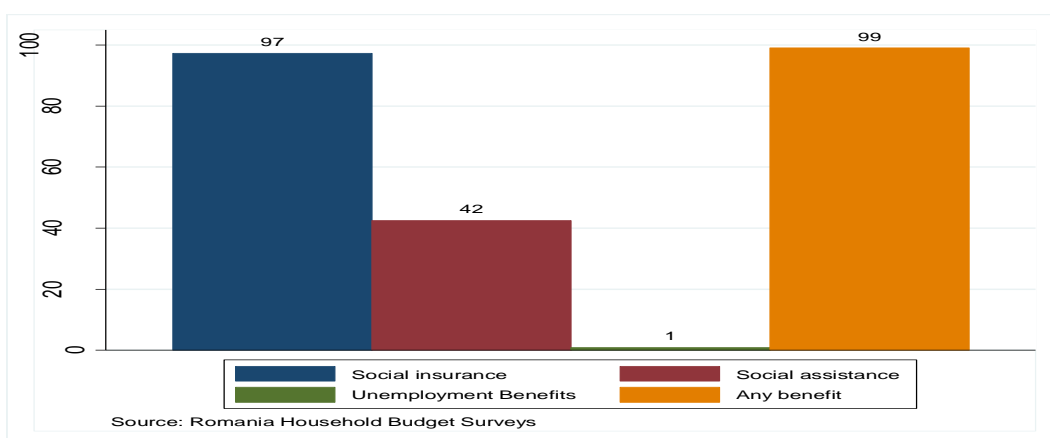
<sup>19</sup> The unemployment benefit is set at 75 percent of the minimum gross wage and is granted for a period of 6 to 12 months depending on the length of service. In addition, school graduates unable to find employment are entitled to an allowance of 50 percent of the minimum gross wage for a period of six months.

sizable increase in the budget for pensions in 2008 followed by the economic contraction in 2009, total spending increased to 6.4 percent and 8 percent of GDP in 2008 and 2009 respectively. Spending on the main social assistance benefits is around 2 percent of GDP of which 70 percent is cash benefits, but many of these benefits have low adequacy. Romania has no social assistance scheme specifically for farmers, but farmers can benefit from the general social assistance benefits if they meet the eligibility criteria.

36. Overall, Romania’s social protection system provides good coverage. Social protection benefits reach 85 percent of the population either directly or indirectly and account for about one-quarter of an average household’s income. According to the Household Budget Survey data, in recent years 82 percent of households (85 percent of individuals) were receiving at least one social protection benefit, and half of them were receiving two or more benefits. The share of social protection (direct and indirect) beneficiaries is higher in rural areas than in urban areas (88 percent and 78 percent respectively), mainly due to the larger household size (i.e., more indirect beneficiaries) and to farmers’ pension (which is predominant in rural areas). Social protection benefits (both contributory and non-contributory) covered 88 percent of the poorest the poorest 10 percent of the population. The coverage of rural households is slightly higher at 90 percent. Despite this, poor farmers, one of the most vulnerable categories of Romanians as identified by the 2007 Poverty Assessment, have the least coverage (83 percent). Their persistent poverty status after receipt of social protection benefits is most probably due to low benefit levels and/ or living in large (and poor) households.

37. In 2009 around 99 percent of households with an elderly farmer member received some form of social protection benefit, including non-contributory benefits (in other words, social assistance). Social assistance covered around 42 percent of households with an elderly<sup>20</sup> farmer, while social insurance benefits provided coverage to around 97 percent of elderly farmer households (Figure 6).

**Figure 6: Percentage of Elderly Farmer Households Receiving Social Protection Benefits, 2009**



<sup>20</sup> Elderly is defined as those above age 60 and 65 for women and men respectively.



### *Elderly Farmers and the Pension System*

38. Romania's pension system consists of three pillars. The first pillar is a publicly managed contributory system linked to earnings, which seeks to replace a portion of pre-retirement income and is financed on a pay-as-you-go basis (meaning that contributions from current workers are used to pay benefits to current beneficiaries). The first pillar provides old age, disability, and survivorship pensions and is administered by the House of Pensions (CNPAS). In 2001, the defined benefit formula, which is used to calculate pensions under the traditional first pillar scheme that was an inheritance from the socialist times, was replaced with a new formula based on points that eliminated the re-distributional aspects of the pension scheme and strengthened the link between contributions and benefits. The benefits paid under this first pillar are calculated from an individual's accumulated points, which are determined by his or her wages relative to the average wage. A minimum pension was introduced in 2009 to mitigate the impact of the economic crisis on recipients of low pensions. The minimum pension is a top-up benefit provided to those pensioners who receive a pension amount that is lower than the set minimum. The second pillar, which became operational in 2008, is a privately managed, fully funded, defined-contribution, earnings-related scheme. Under the second pillar, some portion of a worker's contributions is diverted to the pension fund management companies to be invested. The level of second-pillar benefits that is paid out is a function of an individual's contributions and investment earnings, but the procedures governing the payout of benefits are yet to be established. The third pillar is an optional, privately managed, fully funded, defined-contribution pension scheme, intended to provide individuals with a way to supplement the benefits that they are paid by the mandatory pillars.

39. The Romanian public pension system is fiscally unsustainable. Comprehensive reforms since 2001 combined with more effective revenue collection and supported by steady economic growth improved its financial performance to achieve a fragile surplus of 0.3 percent in 2006 and 0.2 percent in 2007. This favorable fiscal situation was soon reversed due to the impact of the economic contraction and to several policy decisions made in 2007 and 2008. These included the granting of additional pension increases to certain groups of workers and the introduction of sizable increases in the pension point value (in other words, a generous indexation of benefits). The result was a deficit of around 1.3 percent of GDP in 2009. Projections suggest that the pension scheme will face even greater fiscal challenges as a result of the rapidly aging population. The number of beneficiaries will eventually be higher than the number of contributors, resulting in a projected deficit of 5 percent of GDP by 2025. In order to address the fiscal sustainability issue, which has been exacerbated by the impact of the crisis, pension reform law was issued in 2010. The draft law proposes to change the generous indexation of benefits increase the retirement age for women, and to address issues related to early retirement and disability that contribute to a fiscally unsustainable pension system. These reforms, if they are implemented, would yield considerable fiscal savings.

40. About 92 percent of the elderly farmers are direct beneficiaries of social insurance benefits. This comprehensive coverage comes mainly from three sources: old-age pensions, farmers' pensions, and, to a much lower extent, survivors/ veterans pensions (Table 3). Although the current figures seem impressive, the future coverage of elderly farmers with pension benefits (old age, and respectively farmers' pensions) is expected to drastically decrease for reasons that are explained below.

**Table 3: Direct Beneficiaries of Social Insurance Benefits**

	All Farmers	age		
		45-54	55-64	>=65
All social insurance	36.0	14.3	57.8	92.4
Old age pension	16.4	1.7	28.5	43.7
Disability pension	3.8	11.3	9.5	0.3
Survivor's + War veterans (including survivor of) pension	3.5	1.1	3.2	10.8
Social assistance pension	0.1	0.1	0.2	0.0
Farmer pension	13.6	0.2	17.0	42.0
All labor market programs	1.0	1.5	0.2	0.0
Unemployment benefits + Redundancy payments	1.0	1.5	0.2	0.0

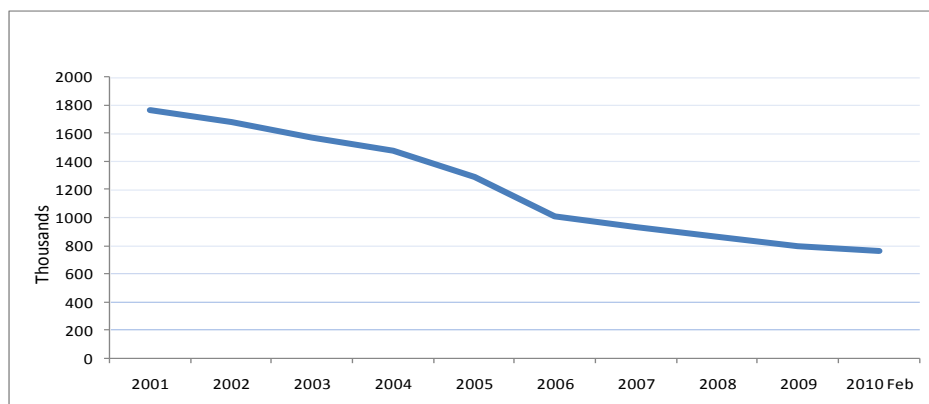
Source: HBS

41. The current old age pension scheme is voluntary for farmers, but there is no official record of how many farmers participate in the scheme because the House of Pensions (CNPAS) registers farmers along with all other self-employed workers. However, according to HBS data, hardly any farmers are participating in the pension system, which is disturbing because these farmers will have no access to pension income in the future.

42. The farmers' pension scheme was inherited from the socialist era, most of its beneficiaries being former farmers in the Agricultural Cooperatives. Until 2003 Romania maintained a mandatory enrollment in a social insurance pension scheme for farmers, which was stopped as part of the pension system reforms. Since the system has no new participants<sup>21</sup> the number of beneficiaries is gradually decreasing: as of February 2010, the scheme had 762,000 beneficiaries, down from almost 1.5 million in 2004. The benefits are financed by the state budget and administered by the House of Pensions (CNPAS). In line with the low contributions required, the level of farmers' pensions for which the beneficiaries are eligible are low. However, with the introduction of the minimum pension in 2009, farmers also receive a top-up benefit that brings their pension level up to the set minimum pension. The level of the minimum pension for farmer pensioners and normal pensioners are equal. The minimum pension was RON 300 per month when it was introduced in April 2009 and was increased to RON 350 per month in October 2009.

<sup>21</sup> The elderly eligible for the scheme are those who worked in the Agricultural Cooperatives before 1991, and those who contributed under the mandatory scheme until 2003. This scheme was financed partly by contributions, but also by taxes on agricultural products for some part of its existence.

**Figure 7: The Number of Farmer Pensioners**



Source: MoLSA

43. Recognizing the danger that a majority of farmers will have no access to pension income in the future, in 2008 the Romanian government passed a new law introducing a separate contributory pension scheme for farmers. The government's main motivation in passing the law was to provide an affordable contributory pension scheme for farmers outside the main pension system to ensure that elderly farmers had access to retirement income in the future after the main pension scheme was made voluntary for farmers. The law had an original effectiveness date of January 1, 2010 but was postponed by one year as the government began to realize that a separate farmers' contributory pension scheme would be costly since 75 percent of the contributions would be paid by the state as matching contributions. The state would also have to finance any potential deficit. This means that the new scheme would be contributory only in name and would essentially be a social assistance scheme.<sup>22</sup> Also, the calculation and indexation of benefits under the separate farmer's contributory pension scheme would not be transparent, which would create uncertainty about the fiscal position of the new scheme.<sup>23</sup> Furthermore, once a separate scheme for farmers was established, it would be politically very difficult to undo or reform it as international experience as well as in Romania suggests. Moreover, the government might be tempted to put individual and state contributions towards the social protection of the poor elderly today since the scheme would not have to pay out until the first individuals became eligible for retirement. The state would then finance its matching contributions either through taxation or through debt financing, which would be difficult given its tight fiscal envelope. Hence, a government liability would start to accumulate

<sup>22</sup> In an interview with the Bank team, some CNPAS representatives indicated that no analytical work had been undertaken to project the potential cost of the new pension scheme for farmers before the law was passed.

<sup>23</sup> Depending on the level of percentage identified in the budget law to be used in pension calculation, pensions could be high or low. If the percentage is determined at 0.5 percent (the maximum level) in the budget law, then the lowest full pension provided will be 36 of average gross wage making the rate of return for the individuals contributions paid very high and potentially leading to increased deficit. If the percentage is determined at 0.1 percent (minimum level), then the lowest pension provided would be 7.2 percent of average gross wage which is not a meaningful pension benefit and will potentially create pressure on the policy makers -especially because individuals are paying contributions and there will be an expectation for a meaningful benefit irrespective of the very low individuals contributions paid. Likewise, pension indexation is not transparent. Similar to the current public pension scheme, pension indexation is tied to the value of the contribution unit that is determined as a certain percentage of the average gross wage. Therefore, the benefits implicitly are wage indexed. It is possible to change this percentage through the budget law therefore the indexation is essentially discretionary.

as soon as the scheme became operational. The government is now expected to cancel the legislation.

44. Instead of a separate contributory scheme for farmers, the government is considering introducing a non-contributory benefit (social assistance) for all of the elderly poor (including farmers). The details of this non-contributory program have yet to be decided, but the two main options currently being considered are : (i) to enhance the existing last resort income support program (the Guarantee Minimum Income, or GMI) by designing a specific component for the elderly or (ii) introducing a zero pillar pension (in other words, a social pension).

### *Elderly Farmers and the Social Assistance System*

45. With the exception of some war veterans/ survivors allowances, which have very low coverage, Romania has no non-contributory social protection scheme specifically for the elderly, or targeted to the elderly at poverty risk. The low income elderly are eligible for the minimum income guarantee program (GMI), which is a means-tested scheme providing financial support to households whose income falls below a minimum threshold. The GMI threshold varies according to family size and is indexed on a yearly basis. The families receive social assistance equal to the difference between the GMI threshold and their actual income from all other sources, including their imputed income from assets such as land and livestock. The scheme involves a two-tier testing system – first, a calculation and desk verification of the family’s personal income based on their self-reported income and assets statements ( supported by official documents such as paystubs etc.) and, second, a verification of their means and assets based on direct observations in the family home. The program is administered by local governments, and funding is provided to the local governments from the state budget. In general, the GMI program is well targeted but covers only a small proportion of the poor. Funding for the program is limited, equivalent to only 0.08 percent of GDP in 2009 (down from 0.2 percent in 2004).<sup>24</sup>

46. The role of the GMI has decreased over the past few years. The program covered about 225,000 households in the first trimester of 2010 (about 3 percent of the total number of households), down from 420,000 in 2004. Still, the GMI has the best targeting performance of all Romanian social safety net programs. Compared with the performance of similar programs in neighboring countries, it has wide coverage (around 15 percent of the poorest pre-transfer quintile), moderate adequacy (30 percent of the consumption of poor beneficiaries), and good targeting (84 percent of funds go to the poorest pre-transfer quintile). The program mostly reaches the rural poor (especially poor farmers) and large poor households (especially poor families with children) and covers almost one-third of their consumption.

47. The social assistance system covers only a small portion of the country’s poorest elderly farmers with direct benefits. According to the Household Budget Survey data, in 2009, about 24 percent of all of the elderly farmers belonging to the poorest 10 percent of population were directly covered with individual or family social assistance benefits. Surprisingly, the non-contributory benefits providing the largest coverage of the poor elderly farmers are the allowances for the low-

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<sup>24</sup> World Bank (2008)

income families with children<sup>25</sup>, due probably to the fact that many elderly farmers live in multi-generational households. The GMI covers only about 7 percent of the low-income elderly farmers, while the direct, individual, benefits cover less than 1 percent of them.

**Table 4: Direct Beneficiaries of Social Assistance Programs\***

	All farmers	Elderly farmers (Age >=65)	
		All	Belonging to the poorest decile
All social assistance	30.6	11.6	23.9
Allowances for disabled	0.6	0.8	0.1
GMI (poor families/ households)	8.4	2.1	7.1
Family Allowance (families/ households with children)	24.6	6.7	16.2
Allowances for war veterans, subjects of political persecutions, heroes, etc	0.6	2.5	0.6
Other social assistance benefits	0.1	0.0	0.0

\*In the case of family/ household benefits all household members were considered direct beneficiaries

48. The low coverage of the poor farmers with GMI benefits seems to indicate the existence of barriers or disincentives in accessing the program, especially when compared to the overall coverage of the population belonging to the first decile, which is significantly higher, at 15 percent. A previous study (GMI Evaluation Report, 2003) has shown that one of the biggest barriers preventing farmers in benefitting from the GMI program is their land ownership. According to this report, the program authorities automatically assume that farmers obtain income from laboring on their land even after retirement age. The program uses a definition of income based on cash as well as imputed income from assets, including land, and exclusionary assets filters. The imputed income from land and other assets is determined at local government level, within limits defined by secondary legislation issued by the Ministry of Labor, Family, and Social Protection. The imputation of income from land is done as a function of land type and land size, based on a grid that provides minimum and maximum valuation limits established by the Ministry of Agriculture. Non-productive land (classified as such by the local government) is disregarded, as well as the first 0.15 – 1 Ha of land (function of land type)<sup>26</sup>. Income imputation is done for areas up to 0.5 - 3 Ha (function of land type); the applicants having land above these limits are excluded from the program. An important element that is not taken into consideration when verifying eligibility, and which would be difficult for the social workers performing the eligibility check to verify, is the actual amount of land that is used for production. Many rural elderly farmers who own land above the minimum limits and are not able to work their land but have no other source of income are not eligible for GMI benefits.

<sup>25</sup> The family allowances are income-tested (as opposed to GMI which is means-tested). They do not require an imputation of incomes from land/ livestock or exclusionary assets filters.

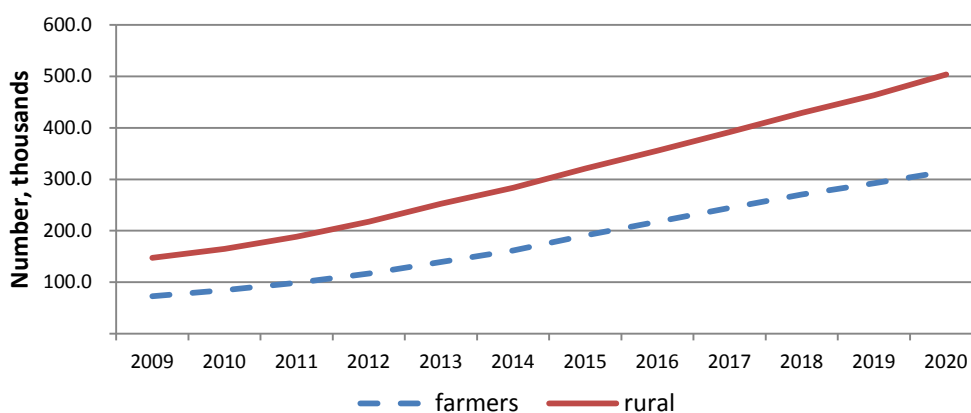
<sup>26</sup> 0.15 Ha for vineyards, 0.25 Ha for forest, 0.5 Ha for arable land and 1 Ha for pastures, for families up to three members. For larger families the limits are 1.8-2 times higher.

## 4. Options for Providing Old Age Income Security to Poor Elderly Farmers

49. Future generations of elderly farmers are likely to find themselves exposed to increased poverty risk. The current cohort of old-age farmers is relatively well covered by the social protection system. However, the phasing out of the farmers’ pension program, the non-participation of the current generation of working-age farmers in the social insurance scheme, and the demographic aging trend are likely to result in a large cohort of farmers who will be unprotected against old age poverty. About 40 percent of non-elderly farmers are already in the poorest quintile. Over the next 10 years, 450,000 farmers who are now in the 55 to 64 age group will reach retirement age, and about one-third of them will not be covered by the pension system. For the next generation (those who are now in the 45 to 54 age groups), the situation will be even worse, since they are not paying any contributions to the social insurance fund.

50. Elderly farmers are not the only group at risk – most of the rural elderly will face a similar situation, since many of them are former farmers<sup>27</sup>. The number of rural elderly who will not be covered by pensions in the future is likely to be even larger (Figure 8).

**Figure 8: Rural and Elderly Farmers Not Covered by Social Insurance Pensions**



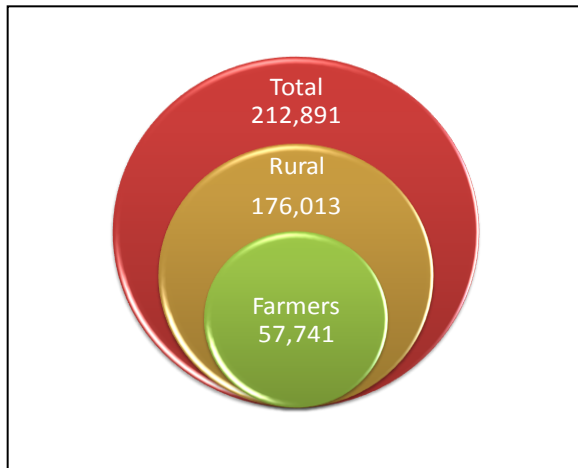
Source: Authors’ computations

51. Moreover, as the discussion in the previous sections clearly shows, it is difficult to define a farmer for both analytical and policy purposes, but any options that would cover the elderly poor in Romania would include farmers. An overwhelming majority (over 85 percent) of the poorest of the elderly live in rural areas, and thus the cost of covering the entire vulnerable elderly population would be marginal. In addition, taking a nationwide approach would avoid creating any inequities

<sup>27</sup> The available data from the HBS do not contain any reliable measures of the number of former or retired farmers. The survey used an operational definition of farmers based on the performance of farming activities, which will not have captured “inactive” old-age farmers who are not able to work, but it is reasonable to believe that most of them are captured in the rural elderly category of the survey.

between the urban and the rural elderly. Therefore, our analysis of the options available for providing old age income security to elderly farmers aims to cover all of the elderly poor. This provides us with an upper bound of the cost estimates compared with the costs of a categorical benefit for the elderly farmers and/or to the rural elderly.

**Figure 9: The Elderly (over the age of 60) in the Poorest 10 percent of the Population in 2009**



Source: HBS

#### 4.1. Fiscal and Poverty Impact of the Available Options

52. There are several different ways to design a program to provide adequate non-contributory benefits to the vulnerable elderly. The first and most fundamental choice relates to whether to provide a universal (categorical) benefit or a targeted benefit. Second, policymakers need to choose the “assistance unit,” meaning that they need to decide whether they want to award the benefit to the individual or to the household. A third important choice is whether the benefit should be integrated into the existing social assistance program (in Romania’s case, the GMI) or whether it should be a universal categorical benefit for the elderly separate from the existing GMI program. The options that we recommend in this note are shaped by the following parameters:

53. *Demographics:* The population to be covered, in this case consisting of people old enough to qualify for a pension, is a fixed parameter. The standard retirement age in Romania is currently defined as 60 years old for women and 65 years old for men.

54. *The welfare status of the beneficiary:* Whether or not the program will take into consideration the welfare status of the potential beneficiary will determine whether the program will be universal (categorical) or targeted (income or means-tested). Targeted benefits would be paid only to those applicants who in addition to other eligibility criteria have incomes lower than a certain threshold. The universal (categorical) benefits would be paid to all applicants regardless of their welfare level who satisfied the program’s eligibility criteria.

55. *Type of benefit and assistance unit:* If policymakers chose to define the individual as the assistance unit, then the program would be a social pension. The recipient of the benefit would be the pension-aged individual, and the benefit amount would not take into consideration the size of

the recipient's household. However, any means test would have to take into account the income of the whole household not just that of the recipient (this will be discussed further below). If the family or household of the elderly person were chosen as the assistance unit, then the program could be designed as an extension of the GMI. In this case, the benefit amount would be the computed function of the family or household's characteristics, including its size, and all household members would be considered to be direct beneficiaries of the program.

56. *Coverage with social insurance pensions:* If the preferred option were the social pension, then the scheme would aim: (i) to protect those who are not currently protected against old age risks and (ii) not to create disincentives to enroll in the social insurance schemes. In this case, all beneficiaries of social insurance pensions would not be eligible. In the case of the extended GMI, pensioners would not be excluded, but pension income (as well as any other verifiable income of the household members) would be included in the means test.

57. *Threshold (Basic Benefit) level:* To estimate the fiscal implications of each option, we used a basic benefit/ threshold of 200 RON per month, which represents about 60 percent of the current minimum pension (350 RON), and about 1.1 of the extreme absolute poverty line in Romania. With these parameters, the program would avoid creating disincentives to contribute to the social insurance schemes.

58. *Benefit amount:* Policymakers would also have to choose between a flat benefit (the same amount for all beneficiaries) and a differential benefit (in other words, calculated as the difference between a set threshold and the current income of each beneficiary). If the universal/ categorical approach is chosen, then all eligible recipients are supposed to receive the same amount of benefit (basic benefit). If the targeted approach is opted for, then the benefit amount can vary by imposing a "tax" on the current income of the beneficiary. We simulated two extreme alternatives – zero tax and 100 percent tax. The first option would pay a full basic benefit (at a flat rate) to all recipients, while the second one would pay the difference between the basic benefit, or threshold, and the recipient's current income (in other words, the basic benefit minus a 100 percent tax on other income). Other options that could be considered but that we have not analyzed in this note would be to set a different tax level (for example, 80 percent) or to set two or three fixed benefit amounts as a function of the income category to which the beneficiary belongs or just one flat benefit amount but lower than the eligibility threshold (for example, 150 RON).

59. The various combinations of these design parameters result in three main policy options, starting from what we consider to be the two main design choices: (i) the universal (categorical) versus means-tested (MT) approach and (ii) a new social pension versus extending the GMI. Since the extended GMI is by definition a targeted benefit, this yields three main options: (a) a universal social pension; (b) a targeted social pension, and (c) an extended GMI. Within the second option (b), we analyzed two alternatives: (b1) an individual flat benefit and (b2) an individual differentiated benefit. Thus, we ended up with four main scenarios (Table 5), which can be further refined by benefit/ threshold levels.



**Table 5: Social Assistance Schemes for the Elderly Poor**

Scenario	Type of benefit, target group, and eligibility	Benefit amount/ formula
a) Universal social pension (Categorical)	<ul style="list-style-type: none"> <li>• Non means-tested</li> <li>• Individual benefit</li> <li>• Granted to all elderly people of pension age who do not benefit from the social insurance pension</li> </ul>	Flat benefit of 200 RON
b1) Flat means-tested social pension	<ul style="list-style-type: none"> <li>• Means-tested (verifiable incomes)</li> <li>• Individual benefit</li> <li>• Granted to elderly people of pension age who do not benefit from the social insurance pension and whose HH per capita income is under a certain threshold</li> </ul>	Flat benefit of 200 RON
b2) Differential means-tested social pension	<ul style="list-style-type: none"> <li>• Means-tested (verifiable incomes)</li> <li>• Family benefit</li> <li>• Granted to all households that include an elderly person of pension age and whose HH income is under a certain threshold</li> </ul>	Difference between observed HH income per capita and the eligibility threshold (200 RON)
c) Extended GMI differential means-tested family benefit	<ul style="list-style-type: none"> <li>• Means-tested (verifiable incomes)</li> <li>• Family benefit</li> <li>• Granted to all households that include an elderly person of pension age and whose HH income is under a certain threshold</li> </ul>	Difference between observed HH income and a threshold using the GMI equivalence scale (200 RON for one-person family, 360 RON for two people, 500 RON for three people, and so on, according to the current GMI scale)

60. There are several pros and cons for these various scenarios, as well as several design elements of the programs that need further discussion. Before we present the estimated number of beneficiaries and cost for each scenario, it is worth noting some of these.

- For the targeted social pensions scenarios (b1 and b2), we opted to means-test household incomes rather than individual incomes since the most common individual incomes of the elderly are pensions and we had already excluded those elderly people who are covered by the social insurance pension. Also, it is difficult to attribute other types of income from, for example, rent or land to a specific person. Testing the individual incomes of the elderly with no social insurance pension would increase the program’s administrative costs and would be likely to lead to a similar outcome as taking the universal approach.<sup>28</sup>
- All of the means-tested schemes are presumed to be based on income (cash or in-kind) that can be verified. Therefore, we suggest that imputed incomes from land<sup>29</sup> (below a certain land size limit) should not be considered when designing a new social protection scheme for the elderly (individuals or households). Nevertheless, we recommend that home visits be made by program administrators to verify the household’s ownership of assets or their receipt of any income (cash or in kind) from leasing land or selling agricultural products. Although the exclusion of

<sup>28</sup> One other option could be to offer the means tested pension at a higher age, say at 70. This would reduce the disincentives for regular social insurance which allows retirement at 65/60, and provide protection to the elderly at a later age when they are more likely to be poor.

<sup>29</sup> Imputed income from land is the income that program administrators presume have been received by a household, and are estimated according to a “formula” independent of how the land may or may not have been used. Cash or in-kind incomes from leasing or selling agricultural products are not included in imputed income but are sometimes are hard to verify.

imputed incomes from land could lead to inclusion errors (better-off people being included in the program), this risk can be minimized by introducing appropriate filters (lists of assets) and by verifying income from leasing out land. The main reason for not taking imputed income into consideration is the risk of excluding the elderly who own land but are not able to use it or benefit from it. Another option to consider is excluding the first two hectares of land and to impute income only for any land above this limit, but not to use land ownership as a filter with conservative limits, as this proves to be not conducive to land consolidation but only to exclusion errors.

- For the extended GMI scenario (c), we do not restrict eligibility only to the elderly not covered by social insurance pensions since this would complicate the selection mechanism and would lead to inequity between different households with elderly members with the same welfare status.
- There are pros and cons for providing benefits to individual as opposed to the family or household within an extended GMI.
  - Elderly people not covered by social insurance pensions are more likely to live in large households than those who are covered (see Table 9). Since poverty is a household characteristic, an individual social pension may only marginally increase household well being (measured by per capita household income), but at the same time it may exclude the family or household from other benefits (the GMI, for example, which also provides basic health insurance for its beneficiaries). On the other hand, an individual benefit could confer more security on elderly household members by reducing their dependency on other household members and thus strengthening their position in the household. But since the GMI benefit would also be provided based on the presence of the elderly in the household, the GMI option would also contribute to the position of the elderly member in the household.
  - A family or household benefit would ensure a more adequate level of income support for all household members (assuming the intra-household distribution is an equitable one) and would therefore be a more effective tool in reducing overall poverty. On the other hand, extending the GMI by designing a special component for households with elderly members with different eligibility criteria (for example, a higher threshold) might be difficult to implement and administer and could be opposed by other beneficiaries as inducing inequity in the system.
  - An individual benefit targeted to the elderly, such as a social pension, could be seen as being more legitimate and thus more predictable than other options and not as affected by the political economy of a last resort household income support program (i.e., GMI), which is often the first to be under-financed. On the other hand, designing a separate program for poor elderly people would risk making the GMI unsustainable from a political economy perspective.

61. The simulations of the various options presented in Table 6 are based on data from the 2009 Household Budget Survey and assume “perfect implementation” (for example, full take-up, no errors in income-testing, and no attempt by the applicants to cheat the system by under-declaring their income). The cost estimates do not include administrative costs, which are usually higher for means-tested programs than for universal benefits. In Romania, the administrative cost

of the GMI has been estimated to be 11 to 12 percent of the total cost, which is not a very high figure. Also, the simulations do not capture the “crowding out” effect of social pensions or any other behavioral responses by individuals or households to the introduction of a new social benefit. As mentioned before, the enrollment of an elderly person in a social pension program may disqualify the household from being eligible for other income support programs such as the GMI. The introduction of a social pension is likely to necessitate a mass recertification process of those households that are currently benefitting from the GMI.

62. A universal program would be more expensive than a targeted one even though its administrative costs might be lower. Table 6 provides the estimates of the number of beneficiaries and cost for each scenario discussed above. As expected, the option that costs the most (0.1 percent of GDP for a benefit of 200 RON) is the universal scheme. Even if we assume an administrative cost of 20 percent for the targeted programs, the cost of the universal pensions still remains the highest. The estimated number of beneficiaries for a means-tested social pension (options b1 and b2) is only about 15 percent of the estimated number for a universal social pension scheme (option a). The extended GMI would cost more than the means-tested social pension but would cover more elderly people by including pensioners living in poor households with low income per household member. If the extended GMI were chosen, *the additional cost* to the current system would be less than 0.01 percent of GDP since some of the targeted households are already enrolled in the system (see the last row of Table 6).

**Table 6: Options: Estimated Fiscal Impact in 2010**

		total elderly	rural elderly	elderly farmers
a) universal social pension	amount, million RON	551	358	175
	percent of GDP	0.108	0.070	0.034
	number of beneficiaries (elderly persons)	229,697	149,043	73,002
b1) flat MT social pension	amount, million RON	91	81	42
	percent of GDP	0.018	0.016	0.008
	number of beneficiaries (elderly persons)	37,838	33,806	17,674
b2) differential MT social pension	amount, million RON	30	28	14
	percent of GDP	0.006	0.006	0.003
	number of beneficiaries (elderly persons)	37,838	33,806	17,674
c) extended GMI	amount, million RON	131	119	40
	percent of GDP	0.026	0.023	0.008
	number of beneficiaries (households with elderly)	78,520	69,257	25,866
	number of elderly beneficiaries	90,167	80,293	29,249
Estimated transfers of the current GMI to households with elderly (for reference)	amount, million RON	101	63	28
	percent of GDP	0.020	0.012	0.006
	number of beneficiary households with elderly currently covered by the existing GMI scheme	41,198	31,128	13,218

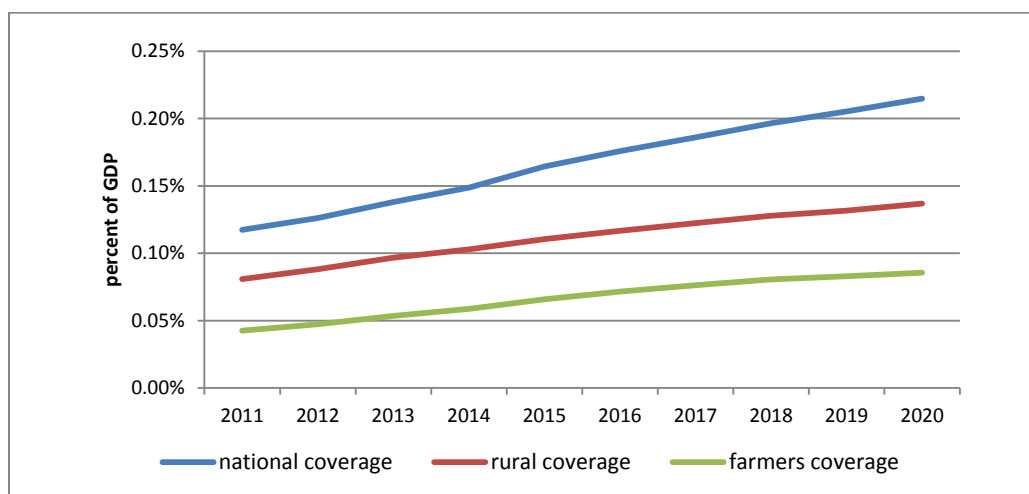
Source: Authors' computations

Notes: 2010 GDP of 510,449 million RON. Figures reporting costs are rounded.

63. The cost of a universal social pension would significantly increase in the future as the population ages and social insurance coverage declines. As the cohorts who are not participating in the current social insurance scheme reach retirement age, they will require support from the social protection system and their numbers will increase as life expectancy in Romania increases.

Therefore, the fiscal burden of the universal pension would more than double in 10 years to more than 0.2 percent of GDP.

**Figure 10: Simulated Cost of the Universal Social Pension as % of GDP**



Source: Authors' computations

64. To estimate the poverty impact of the proposed options, we made several assumptions. First, we assumed that poverty/ well being are household characteristics, and thus we assessed the well being of individuals by looking at the welfare status of their households. Second, we assumed that beneficiaries share their benefits with the other members of their households as a contribution to the household income. So we estimated the benefit impact on both direct and indirect elderly beneficiaries. Third, for convenience, we used the 2009 poverty parameters, including the definition of poor population (a poverty rate of 4.4 percent, meaning almost 1 million poor) and assumed no change in the consumption level or distribution in 2010.

**Table 7: Reduction in the Number of Poor under Different Policy Options (%)**

	Reduction in Poor Elderly at pension age, not covered by social insurance pensions			Reduction in Poor Elderly at pension age, all			Reduction in Total poor
	National scheme	Rural scheme	Farmers scheme	National scheme	Rural scheme	Farmers scheme	National scheme
a) universal social pension	85	85	90	24	25	26	5
b1) means-tested flat social pension	85	86	88	16	18	21	4
b2) means-tested differential social pension	34	32	41	6	6	9	1
c) extended GMI	38	39	40	18	20	14	5

Source: Authors' computations

65. According to our projections, the proposed options would have different outcomes in terms of reducing poverty or increasing well being. Table 7 presents percentage reduction in number of poor in the following categories: (i) elderly people not covered by the social insurance pension (the expected impact on intended direct beneficiaries); (ii) all elderly people of pension age (the expected impact on all of the elderly); and (iii) all poor people (the expected impact on all

poor, direct and indirect beneficiaries) in the case of a nationwide program. The results are in line with our expectations. The individual universal benefit, being the most generous, would have the biggest impact but at the highest cost. The flat means-tested social pension would do almost as well as the universal benefit but at a much lower cost. The differential means-tested benefit, because of its conservative thresholds and lower average levels of benefit, would have the least impact but at the same time the lowest cost of all of the options under consideration. The extended GMI would lead to a large reduction in overall poverty and would perform better than the differential means-tested individual benefit. The fact that it would not reduce the number of poor elderly substantially is probably due to the flat equivalence scale used (and thus more conservative threshold for large households) and also to the fact that it would be a differential benefit. Because of the equivalence scale, the extended GMI would have a more restrictive eligibility than the other options in which the thresholds would not decrease as household size increases. The GMI will cover a larger number of poor elderly, but will provide lower benefits than the more generous flat social pension. At the same time, when all poor elderly (and not only to those not covered by social insurance pensions) are covered, the GMI has a similar impact with the flat means-tested social pension (18 and 16 percent reduction in poverty for the GMI and flat means-tested social pension respectively).

66. In order to refine our analysis of the poverty reduction impact of the various scenarios and to bring the simulations closer to the real-life policymaking, we applied a constraint fiscal cost equal to the cost of the extended GMI. As expected, we found that, under the constrained budget scenario, the poverty impact of the universal benefit dropped below the other scenarios, while the outcomes of the other options remained unchanged. Assuming a budget equal to that of the extended GMI, the universal social pension would only be able to deliver less than one-third of the threshold (basic benefit) level, and as a result, its impact would diminish significantly.

**Table 8: Universal Social pension: Benefit levels and Poverty Reduction under a Constrained Budget Scenario**

		total elderly	rural elderly	elderly farmers
a3) universal social pension assuming a constrained budget equal to the extended GMI	amount, million RON	131	119	40
	<b>benefit amount RON</b>	<b>47</b>	<b>67</b>	<b>45</b>
	number of beneficiaries (elderly persons)	229,697	149,043	73,002

	Elderly at pension age, not covered by social insurance pensions			Elderly at pension age, all			Total poor
	National scheme	Rural scheme	Farmers scheme	National scheme	Rural scheme	Farmers scheme	National scheme
a3) universal social pension, under a constrained budget equal to the extended GMI	29	42	34	8	11	11	1

Source: Authors' computations

67. The cost and poverty impact criteria pointed to the flat means-tested social pension as being the most effective and efficient instrument to support the vulnerable poor and to the GMI as being the second best. Based on the constant (constrained) budget scenario the means-tested flat social pension ranked first in reducing poverty (85 percent reduction), and GMI ranked second (38 percent reduction). Moreover, if we look only at costs, the GMI requires the lowest fiscal outlay

since the program is already covering almost two thirds of the poor elderly target group and the additional budget needed to expand the scheme would be less than 0.01 percent of GDP. However, in deciding among the two main options, policymakers must also take into account the current institutions of the social assistance system and the level of integration of various benefits.

#### **4.2. Administrative Feasibility of Proposed Options**

68. Romania has plenty of experience in implementing means-tested social assistance programs on which it can build. Both preferred options (the MT social pension and the extended GMI ) would require the verification of household incomes as is already required in the current GMI and family allowances regulations. The main difference would be either that imputed incomes from agriculture would not be taken into consideration in the calculation of income or that the imputation would be made only for those households that owned land over a certain limit (for example, two hectares or four ESU). Either option could be implemented by the local governments, which are already implementing the GMI and the family allowances.

69. Romania embarked recently in a process of reducing fragmentation and increasing efficiency of its social assistance cash benefits system. Introducing a new benefit might increase the complexity and fragmentation of the social assistance system and would certainly require the recertification of the over 40,000 households with elderly members that are currently benefitting from the GMI. Although both options seem equally feasible, introducing a new benefit in the form of a social pension would require more institutional/ administrative capacity at the local level since the new program will have to be administered separately from other programs, and would be likely to increase administrative costs (including the costs of monitoring at the central level for the same reasons). Adding onto the foundation of the existing GMI would incur lower administrative costs and would allow for a smoother transition, but at the same time would be less effective in reducing the poverty of the elderly not covered by the social insurance system. However, it will be as effective as the social pension in reducing the poverty of all elderly, insured or non-insured.

**Table 9: Characteristics of the Elderly in Romania in 2009**

	All population, persons						Not covered by social insurance pensions, persons					
	Elderly		Rural elderly		Farmer elderly		Elderly		Rural elderly		Farmer elderly	
	Count	Column N %	Count	Column N %	Count	Column N %	Count	Column N %	Count	Column N %	Count	Column N %
<b>HH size</b>												
1	879,119	23%	491,547	24%	176,861	23%	16,982	7%	14,230	10%	7,054	10%
2	1,616,722	43%	846,089	41%	376,761	49%	118,380	52%	73,492	49%	37,876	52%
3	467,213	12%	234,796	11%	79,797	10%	34,624	15%	21,267	14%	12,371	17%
4	287,605	8%	151,225	7%	52,845	7%	19,299	8%	9,284	6%	4,334	6%
5 or more	504,111	13%	333,396	16%	79,045	10%	40,412	18%	30,770	21%	11,367	16%
<b>Gender</b>												
- male	1,299,224	35%	737,139	36%	290,929	38%	18,814	8%	13,379	9%	7,234	10%
- female	2,455,546	65%	1,319,914	64%	474,380	62%	210,883	92%	135,664	91%	65,768	90%
<b>Marital status</b>												
- married	2,041,068	54%	1,114,463	54%	481,870	63%	179,138	78%	112,493	75%	56,988	78%
- living together	64,337	2%	34,308	2%	14,406	2%	6,483	3%	3,960	3%	2,110	3%
- divorced/ separated	80,455	2%	19,730	1%	6,851	1%	2,555	1%	920	1%	685	1%
- widowed	1,539,417	41%	873,345	42%	256,897	34%	36,040	16%	27,341	18%	12,023	16%
- unmarried	29,493	1%	15,207	1%	5,285	1%	5,481	2%	4,329	3%	1,196	2%
<b>Consumption deciles</b>												
1	245,293	7%	200,691	10%	69,960	9%	44,494	19%	38,299	26%	17,170	24%
2	338,334	9%	254,007	12%	91,949	12%	38,253	17%	27,828	19%	14,583	20%
3	390,455	10%	275,951	13%	101,236	13%	32,665	14%	22,014	15%	10,473	14%
4	408,878	11%	268,605	13%	96,038	13%	28,467	12%	17,717	12%	6,158	8%
5	392,422	10%	234,294	11%	86,673	11%	23,285	10%	12,391	8%	5,833	8%
6	420,438	11%	230,630	11%	94,220	12%	20,864	9%	11,030	7%	7,033	10%
7	442,658	12%	217,883	11%	88,255	12%	16,803	7%	9,452	6%	5,526	8%
8	392,432	10%	174,805	8%	59,919	8%	8,224	4%	4,374	3%	2,656	4%
9	390,634	10%	126,771	6%	49,159	6%	8,148	4%	3,035	2%	1,440	2%
10	333,226	9%	73,416	4%	27,900	4%	8,494	4%	2,903	2%	2,130	3%
<b>Area</b>												
- urban	1,697,717	45%	0	0%	48,493	6%	80,654	35%	0	0%	5,325	7%
- rural	2,057,053	55%	2,057,053	100%	716,816	94%	149,043	65%	149,043	100%	67,677	93%
<b>Eligible for MT social pension</b>												
- no							191,859	84%	115,237	77%	55,328	76%
- yes							37,838	16%	33,806	23%	17,674	24%
<b>Verifiable HH income per capita</b>												
Less than 49 RON							1,004	0%	1,004	1%	246	0%
50 – 99 RON							7,437	3%	7,343	5%	4,541	6%
100 – 149 RON							12,876	6%	11,764	8%	4,895	7%
150 – 199 RON							16,521	7%	13,695	9%	7,992	11%
200 RON or more							191,859	84%	115,237	77%	55,328	76%
<b>Eligible for extended GMI</b>												
- no	3,664,603	98%	1,976,760	96%	736,060	96%						
- yes	90,167	2%	80,293	4%	29,249	4%						
<b>Total</b>	3,754,770	100%	2,057,053	100%	765,309	100%	229,697	100%	149,043	100%	73,002	100%

## 5. Conclusion and Recommendations

As discussed above, the objective of this report is to provide recommendations to policy makers in Romania in designing a non-contributory program for the poor elderly including elderly farmers. Rural elderly account for a large part of the poor elderly population and at the same time they are poorer. The average farm size in Romania is small and the majority of small farms are owned by the elderly and these farms provide low incomes. At the same, time due to the small average farm size in Romania, availability of agricultural subsidies to Romanian farmers (including the elderly) from the European Union agricultural subsidy programs is limited. Moreover, current farmers cannot participate in the existing contributory pension system as the pension system requires payment of contributions for benefit eligibility, which is not affordable for most farmers due to their low incomes. The combined effect of all of these factors is that increasing numbers of elderly farmers will be left without a benefit particularly under the aging of the population. These challenges are causing a concern about social protection of the poor elderly (farmers) in Romania. This is because future generations of elderly farmers are likely to find themselves exposed to increased poverty risk.

This paper analyzed three main options for a non-contributory benefit for the elderly in Romania.

- Universal Benefit (Option a): A non-means tested individual benefit provided to all elderly of pension age who do not benefit from the social insurance pension.
- Means Tested Social Pension (Option b) : An individual benefit provided to elderly of pension age who do not benefit from the social insurance pension and whose household per capita income is under a certain threshold. Within option b, we analyzed two alternatives (option b1) an individual flat benefit and (option b2) and individual differential benefit provided as the difference between the household per capita income and the eligibility threshold.
- Extended GMI Differential Means Tested Benefit: Family benefit provided to all households that include and elderly of pension age and whose income is under a certain threshold.

Based on our analysis, the universal social pension is the most effective in reducing poverty. In addition it removes the stigma associated with means test. At the same time, it is not the most efficient as the wealthier elderly are also eligible for the benefit. Furthermore, it would add to the current fragmentation of the system.

The option that proposes a flat means tested social pension (option b1) is effective as it costs a fraction of the amount of the universal benefit and has a similar poverty impact. Since it is a new benefit, it would require improved institutional capacity at the local and central level. At the same time, similar to the universal pension, it would lead to a fragmentation of the system. This option would not be consistent with the current objective of the Government to harmonize and simplify eligibility procedures.

The GMI option involves changing the existing GMI eligibility criteria to modify and extend it to the elderly poor. The GMI, Romania's main poverty targeted program covers only seven percent of the poor elderly farmers. A previous study has shown that one of the biggest barriers preventing farmers in benefitting from the GMI program is their land ownership. Many rural elderly farmers who own land above the minimum eligibility limits are not able to work their land, but have no other source of income are not eligible for GMI benefits. The option presented (option c) proposes that imputed income from land would not be taken into consideration or that the imputation would be made only for those households that owned land over a certain limit (higher than the current one). Since, this option



(option c) is an extension for an existing program (GMI), it is expected to be less expensive to implement, and consistent with the recent trends of reducing fragmentation and increasing efficiency of the Romanian social assistance system.

The Government of Romania took one step further and has embarked on a comprehensive reform of its social assistance system. The government adopted a Social Assistance Reform Strategy in February 2011. The key rationale for the Government's Strategy is to improve the equity of the social assistance system, reduce its fiscal cost, and simplify the service delivery. In this context, the Government is planning to gradually improve the targeting accuracy of the social assistance system, by changing the program mix, changing the eligibility and benefits parameters of selected programs, and harmonizing the institutional framework. The objective is to gradually move to consolidate all means-tested programs into one larger program for low-income households that will provide adequate support to all poor including the elderly.

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#### **Legislation**

Commission Decision of 7 June 1985 establishing a Community typology for agricultural holdings (85/377/EEC); published in the Official Journal of the European Union L 220 from 17.08.1985, 1-35.

Commission Decision of 24 November 1999 relating to the definitions of the characteristics, the list of agricultural products, the exceptions to the definitions and the regions and districts regarding the surveys on the structure of agricultural holdings (2000/115/EC); published in the Official Journal of the European Union L 38 from 12.02.2000, 1-57.

Commission Regulation (EC) No 1535/2007 of 20 December 2007 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid in the sector of agricultural production; published in the Official Journal of the European Union L 337 from 21.12.2007, 35-42.

Council Regulation (EC) No. 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD). Official Journal of the European Union L 277/2005.

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## **Annex 1: New Legislation on a Contributory Pension Scheme for Farmers**

The law issued in November 2008 (to be effective on January 1, 2010) introduces a separate contributory pension scheme for farmers. The new scheme will be administered by the House of Pensions CNPAS). A new department - the Farmers' Pension Department - will be created within the CNPAS to administer the scheme.<sup>30</sup>

### ***Coverage and Financing***

The new scheme will cover individuals between the ages of 16 and 63 who carry out farming activities (including farming activities within the household and will be financed on a pay as you go basis meaning that contributions from the plan participants and matching contributions from the state will be used to finance the benefits. The law introduces five categories of individual contributions and matching state contributions. State contributions are three times the individual contributions. In addition to the matching contributions, the state will finance the deficit.

### ***Benefits and Eligibility***

The new scheme will provide old-age, disability survivor and death benefits. Participating farmers are eligible for a full pension after 30 years of contributions at age 63. Benefits are calculated based on contribution units earned during the working period. Individuals earn contributions based on the contributions paid. Consistent with the four categories of contributions paid, there are four levels of contribution units that can be earned during a specific year with minimum and maximum annual contribution units 360 and 1080 respectively. Benefits are based on the average total contribution units (calculated by dividing total contribution units earned during work period by the years of service). The average contribution unit is then multiplied by the *contribution unit value* identified as a product of 1/5 of the gross average wage and a certain percentage that can be between 0.1 percent and 0.5 percent (the percentage for a specific year is identified in the budget law). Depending on the level of this percentage identified, the lowest full pension provided from the farmers' pension scheme would be between 7.2 percent and 36 percent of average gross wage and the highest benefit provided would be between 21.6 percent and 108 percent of average gross wage (three times the lowest full pension).

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<sup>30</sup> According to the law, CNPAS can assign 200 employees to administer the scheme. Farmers' pension scheme will be administered by territorial pension authorities to be established throughout the country. The cost of administering the scheme will be financed through the state budget with a maximum limit of 30 percent of total expenditures.

## Annex 2: Early Retirement Schemes in Ireland [Why is this in a box?]

Early retirement schemes have been implemented in Ireland since 1965 but with only limited success. In the 1970s, the ERS did not attract significant numbers of applicants - until the introduction of EU co-funding in 1994. Between 1994 and 1999, a total of 10,300 farmers transferred 283,000 hectares to 11,000 transferees. The program was evaluated positively by the participants and also in terms of its positive structural effects (for example, on average six years earlier retirement than initially planned, farm growth etc). In the last period, 2000-2006, the Irish ERS transferred land to only 3,266 recipients. This disappointing result was due to drastic changes in Irish agriculture between 2002 and 2005. The major problems have been identified as the following:

- Uncertainty over entitlements under the Single Farm Payment [**explain this**] and the effect of retirement from farming on one's entitlements had a major negative impact on the uptake of the ERS (IRE/RDD 2010). The importance of direct payments as a component of farm income grew between 2000 to 2006 and thus influenced farm-related decisions. Firstly, farmers delayed decisions on the ERS until the single farm payment had been activated. Secondly, decisions about the ERS were based on the fact that productivity was no longer the main factor governing the size of the payments, and farmers could view their land as a reliable source of income even if not for farming. For some, staying in farming and retaining the Single Farm Payment proved more attractive than transferring their land to receive an early retirement pension. A prospering employment market in other sectors meant that there was a lack of transferees. The prevailing economic climate in 2000-2006 was one of significant economic growth and an associated availability of alternative off-farm employment with wage rates above those available from farming. Average income from farming was at or below 50 percent of the average industrial wage over the period compared to 60 percent in the preceding five years.
- A case involving around 1,000 participants of an earlier scheme whose spouses were entitled to a state pension and who had to pay back monies due to miscalculations generated a significant amount of bad publicity for the scheme, which dampened interest in early retirement.

The outcomes of the ERS 2000-2006 were evaluated as follows:

- The scheme reached only 11 percent of eligible farmers, below the 15 percent achieved under the ERS in 1994-1999. The average difference in age between transferor and transferee was 28 years. All in all, only 97,878 ha were transferred (37 percent of the target) of which only around one-quarter were sold.
- The concentration of the ERS in the more commercial farming areas suggests a large element of deadweight in the scheme as it reflects a greater likelihood of earlier succession where the farming operation is already viable. The incentive provided by the ERS, in these circumstances, may just be an added bonus rather than a catalyst for retirement.
- The overall percentage of transferees with some off-farm income was 77 percent. The average proportion of total household income from off-farm work was 23 percent, with earnings equivalent to approximately 37 percent of the average full-time industrial wage. These numbers raise concern about the extent to which transferees will allocate resources into commercial farming.
- The level of the pension (€13,515 at a flat rate of €5,403 plus €338 per ha transferred per year) was rated as sufficient by the stakeholders provided it was not the sole continuing source of income for the retired farmer. Certain problems existed though for beneficiaries of this measure, including the fact that the pension is not index-linked, the requirement not to take on paid employment, and the reduction in the national pension scheme.
- The administration of the ERS is complex, labor-intensive, and costly. It is estimated that the costs of administering the scheme in the period 2000-2006 were €2.9 million per annum. This means that administrative costs, which were nationally funded and separate from the ERS spending, represented almost 4 percent of the yearly cost.

It is clear that during the period 2000-2006, the ERS did encourage land release (particularly in the more intensive farming areas), but low uptake limited the extent to which this success translated into a real impact. It remains to be seen to what extent significant changes occur in the farm businesses of transferees. The ERS of the current funding period was introduced on June 13, 2007, but the scheme has been suspended since April 2010 due to the economic crisis.

*Sources:* Kearney et al (2008), GoI (2010), and IRE/RDD (2010)

