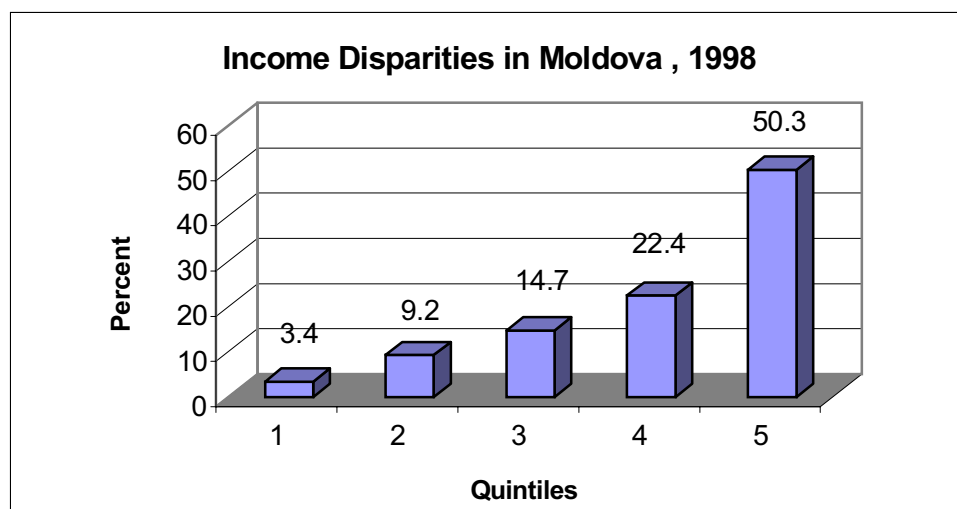


6. Social dimensions of the economic reforms

Social Implications of the Transition. Economic reforms are designed to improve people's living standards. A retrospective analysis of seven years of transition attests to a *deep worsening of all parameters of the quality of life*. The social sector is not able to provide an adequate protection against social risks. The situation registered at the end of 1998 confirms that activities in the social sphere are running inconsistently and with a low efficiency. The reality of the transition has been quite different from what was envisaged during the period of "romanticism" in the early stages of reform, which overestimated the speed and underestimated the costs of transition. The fall in GDP accompanied by a tough monetary policy has entailed significant social costs, which have been rising during the period. Their adverse impact has been felt by the whole collectivity, but it was (and will continue to be) especially painful for the elderly, the disabled, families with many dependent children and other vulnerable groups. In this sense the burden of the economic reform is borne by the people with low incomes, who in fact are in greater need of social protection. Consequently vulnerability and dependence are growing. This fact is confirmed also by the opinion poll made recently by the INSOC-Market, which indicates that only 5% of the population has benefited by the reforms, while about 70% of the respondents said that their living standards have been worsening.

The social implications of reform have a spillover effect onto all components of quality of life, *deepening social polarization*. Massive liberalization of economic activity at the early stage of reform, accompanied by widespread hidden unemployment and salary debts has considerably decreased people's real income. According to some estimation the magnitude of this fall was of approximately 70 percent. As a result poverty has been growing significantly, which leads to a deeper social inequality. The Gini coefficient, which measures the dispersion in the distribution of incomes, increased from 0.34 in 1990 to 0.61 in the first half of 1998 (for comparison, Western countries have Gini coefficients of about 0.35; in Poland, Hungary and the Czech Republic they are about 0.43).

As a consequence of this process, *income inequality* is increasing in Moldova. According to household budget survey data, by the end of 1998 the total income received by the richest 20 percent of the population was 14.7 times the income received by the poorest 20 percent, which compares with a figure of 12.25 three years ago. Today the richest one-fifth of the population receives roughly half of the total disposable income, while the poorest one-fifth has only 3.4%. People with middle income who constitutes the main share of the society (3/5) receive about 46% of the total disposable income. This is a clear indication that the middle class in Moldova is still too fragile to offset the social costs of reform.



The reduction in purchasing power led to a substantial shrinkage of individual consumption. From a society with a scarcity of consumption goods on the market Moldova has become a society with low individual consumption. All components of consumption decreased (foodstuff, durable goods, and services). However, the most significant fall was registered in basic foodstuffs, namely meat –minus 57%, milk – minus 49%, and fish- minus 84%. Consumption is now close to the critical limits, threatening people's normal development as human beings.

Malnutrition affects today not only people with low income, but partially also those with middle income who are employed in the budget sphere (teachers, public servants, medical workers), due to frequent delays in paying wages. According to household budget survey findings, in 1998 the average daily nutritional value per person amounts only to 1976 kcal. This is much less than the minimum nutritional threshold calculated by FAO, of 2100 kcal per day. Thus malnutrition in Moldova is spreading swiftly, compromising the security of nourishment.

The implicit effect of malnutrition has been felt in demographic aspects and the state of the population health. Comparative with 1990, the general death rate has increased by 15% while the birth rate has dropped by 38%. In 1998 for the first time in Moldova the death rate has exceeded the birth rate. Consequently the rate of natural increase of the population has become negative (-0.2 per thousand). This could have a long-term impact on depopulation in Moldova. Complementarily, morbidity, which stays high due to widespread chronic diseases, such as black lung, digestion pathologies, tumors, and cardio-vascular diseases, could exert a great impact on the further human development in Moldova. As a result the demographic dependency ratio is rising which could become a real hindrance for the economic reforms. Now the scope of this phenomenon is much higher than the critical limit (0.11), accounting for 0.31.

The cumulative effect of social costs is reflected in the Human Development Index (HDI), which contains a synthesis of demographic parameters, performance of education, health, and living standards. This index is computed by the UNDP and serves a basis for comparative international analysis. Based on estimations made by the UNDP, Moldova in 1992 held 75th place in the world, achievement which was quite good for that period of time. However, Moldova has since experienced a deep fall in this index, which puts it on 113th place in 1997. Of former soviet republics only Tajikistan, in the 118th position, is behind Moldova in this international rating. The low value of HDI constitutes a warning of difficult situation that persists in the social sectors. The main indicators of in the social sphere are at critical level and could undermine further development of economic reforms, and even put into great danger the *economic security of state*.

The magnitude of the social implications is conditioned mainly by the legacy which the social sphere inherited from the old system. Being completely financed from the state budget, the social sphere was designed to provide services to the whole population regardless of the recipients' level of income and their degree of need. Social commitments had a universal character, and included a wide gamut of benefits, which covered life's ordinary contingencies, i.e. aging, temporary loss of work capability, childcare, entertainment and others.

Social Indicators of Economic Security

	1990	1997	Recommended***
Life expectancy, years	68.5	66.6	
for women	71.8	70.3	
for men	65	62.9	
Birth rate, per thousand	17.7	11**	
Total death rate, per thousand	9.7	11.2**	7-8
Natural increase, per thousand	8.0	-0.2**	
Infant mortality, per thousand	19.0	19.9	10
Fertility coefficient, number of births	1.95	1.667	2.1
Net reproduction ratio, %	93	77	100
Official rate of unemployment, %	N/A	2.3**	5
Hidden unemployment, %	N/A	15.5**	0
Rate of employment of labor force, %	80.7	45**	65-70
Share of foodstuff expenditures, %	34.5	67.9	25-30
Value of nutrition, kcal/day	2969	1976	2100
Social polarization of population, times	N/A	14.7**	5-8
Gini coefficient	0.34*	0.61	0.25-0.3
Coefficient of demographic dependency	0.28	0.31	0,11
Coefficient of social dependency	0.44	0.69	0.2-0.25
Share of social expenditures, % of GDP	18.4	24.8	15
Including for health care, % of GDP	3.8*	5.9	8-9
Annual average health care expenditures per person, lei	N/A	114	210
Including for education, % of GDP	7.8*	8.2	5-6
Annual average expenditures per scholar, lei	N/A	1807**	2460
Pension expenditures, % of GDP	6.1*	9.7	10-11
Rate of salary replacement by pension, %	59	29**	33-35

*- 1992

** - 1998, first half

*** - according the criteria set by the international organizations (UN, IMF, WB).

N/A - data not available.

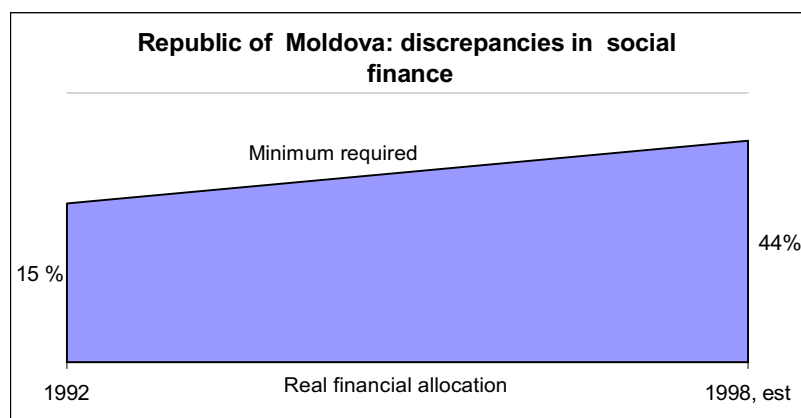
Free universal access to medical and educational services has been intensifying the tendency of their exaggerated growth in volume while they have lost considerably in quality. Thus, on quantitative parameters (number of physicians, beds in hospitals, pupils in schools, and teachers) Moldova could compete even with some of the Western countries. At the same time, however, quality leaves much to be desired.

A significant role in the traditional system of social benefits was attributed to indemnities and compensations in cash. Having as a major purpose the avoidance of excessive income disparities, cash transfers were provided for covering trivial situations, like housing, public transportation, communal services and others. Very often the same person could receive several cash benefits from different sources (state or local budget, social fund) for the same case. *Overlapping and easy eligibility criteria* led to a substantial increase in their number. By mid-1997 there were about 250 types of income transfers. Although measures undertaken further on this issue have reduced to some extent the number of cash benefits, yet their burden remains heavy. At the end of 1998 more than 1 million people in Moldova have been provided with cash benefits, with an estimated value of 1.1 billion lei.

At the same time the *diffuse character of social transfers* has been aggravating their dispersion. Often it is the non-poor groups that have received these benefits. According to household budget survey data, in the first half of 1998 around 1/3 of total social benefits went to rich groups (4th and 5th quintile). This is a good reason to argue that income transfers should be better targeted and provided on basis of means testing. Thus the poor still remain the most vulnerable point in the social assistance system.

Besides that, a large share of social services were provided at the micro level by the enterprises. Using the diverse social institutions (kindergartens, dormitories, sanatoriums, and others) belonging to them, enterprises were able to provide *fringe benefits* to their employees in addition to those benefits received at macro level (from state budget or social fund). Some sectoral findings show that the share of fringe benefits was significantly in electrical industry, chemistry, manufacturing and other branches. Their value could reach 20% of the gross value of wages. Interlacing of fringe benefits with those provided by the state caused fragmentation of the social system, making its management less efficient.

Universal coverage and unclear eligibility criteria have been generating an *explosive increase of social cost*, which constituted a heavy burden for the economy. During the 90s the share of social expenditures increased by 35%, until it represented, in 1998, 1/5 of the GDP. Economic recession accompanied by the fiscal crisis has been eroding the support of social inflows, undermining significantly the sustainability of social finance. Misallocation of resources in concert with low rate of contribution collection has widened the discrepancy between social commitments and financial possibilities. From 15% in 1990, the gap between real allocation of financial resources and the minimal required level reached 44% in 1998. It became as



a common norm chronically delaying in paying wages, pensions, indemnities and other social

benefits. This is a sign that the viability of social finance is on edge of crisis.

It became clear that further maintaining the social sphere in its initial scope and structure is an inadmissible thing, which could constitute a serious impediment for economic transformations. Financial disbalances and disfunctionalities in social sphere activities could lead to a further grow of the burden borne by the economic active population. The coefficient of social dependency grew from 0.44 in 1991 to 0.69 in mid-1998. Today for each 100 people employed in the economy there are 76 beneficiaries of social sphere (pensioners, children, disabled). The practical evidence suggests that for a normal situation this ratio should be 100 to 25. Hence reforming measures should cover all elements of social sectors, namely finance, the structure of benefits and institutional network.

Conceptual Pattern of Social Reform. Although the necessity of reforming the social sectors has been recognized from the beginning and was included in all governmental programs, practical actions undertaken in this regard are too modest. The sensitivity of the social sphere has determined the nature of the conceptual pattern of reform. Having as a major aim provision to all people a decent level of life (objective that is very noble, but not feasible in the current conditions), policy makers plunged into long theoretical disputes about the scope of social reform. Discussions about paths of reforms emerge even now after seven years of transition. Thus the *theoretical aspect of reform prevailed over the pragmatic one*. Consequently, remedial action had a low efficiency.

Apart from that, it was mainly the political environment that conditioned procrastination of social transformations. Affecting foremost welfare of people with low and middle income (who traditionally are the most active part of electorate), social issues have started to be used more frequently by the political parties in their own interest. Social transformations were turned into political issues. *Pressures exerted by the politicians* usually are much greater than real possibilities. As a result promises made during the elections remain unfulfilled. Thus the political populism that is quite common nowadays has a significant adverse impact, lessening the credibility of people in reforming the social sphere.

The unsustainable effects of the environment are amplified also by the inconsistency of political will which is manifested by the policy makers. Being constrained by the financial turbulence and by the excessive polarization of the collectivity, policy makers give preference to scenarios with less degree of risk. Thus so far they have stressed partial and piecemeal reforms, which according to empirical evidence from other countries in transition are more painful and costly for the society. Furthermore, changes made very often in the structure of government have been eroding the political and administrative support for the social reforms. The lack of a main political guarantor who will assume full responsibility for the scope and aims of reforms of the social sphere was undoubtedly a factor of the insignificant progress registered until now in the activities of social sectors.

The major reason in spreading the crisis situation in the social sphere was the lack of a clear and feasible strategy, which should be supported by a set of successive and coherent practical activities. What has been done during seven years could be described as a combination of fragmentary measures, implemented in a sporadic and ad-hoc manner. That can be attributed to the numerous recalculations of pensions and indemnities, unsuccessful attempts at introducing fees for medical services, shallow phasing out of subsidies and

others.

The main disadvantage of such measures is that they attack only one part of the issue

(more frequently this is the financial one), neglecting other sides of the problem (setting policy agenda, benefits structure, institutional network, strengthening administrative capabilities). As a rule such interference is essentially passive, because is not able to anticipate the events, and it is set up after they have emerged. Obviously, performances are insignificant and do not contribute to the social cost reduction.

The 1990s were characterized by a regrettable inconsistency in formulating strategic guidelines for social reform. Each time a government made changes, it also carried out a complete overhaul of the social policy elaborated by the previous governmental team. Usually new government came up with an absolutely new social concept, completely different from the previous one. For instance, at the initial stage of reform (1990-1993) social policy envisaged a massive indexation not only of pensions and salaries, but even of people's savings deposits. Later on this concept was revised as to being too costly. It was replaced by the concept of partial selective and regressive indexation. The same thing happened with nominal cash compensations: sometimes they were cut or postponed, sometimes provided again. These broad changes in concept have further complicated the situation, deepening confusion at the implementation stage.

The analysis of social policy shows that in the conceptual pattern of reforms of the social sphere, *financial approaches prevail*. Being concerned mainly with maintaining the financial situation, policy makers have laid stress on reducing public social expenditures. By the way, at the early stage of reform (1992-1994) even missions of the international financial institutions (WB and IMF) endorsed with some reservations these positions. The cost-saving model has been largely implemented in all sectors of the social sphere: health care, education, social assistance and others. The budgets of these sectors are revised several times during one fiscal year with a view to cutting expenditure. An eloquent example of this is the budget of the social fund, which was revised three times during 1998. By comparison with the initial version at the beginning of year, expenditures from this fund were reduced by 24%. For 1999 the social fund budget will be shrinking further, accounting for only 85% of the final budget registered at the end of 1998 year.

Thus the austerity in allocating financial resources to the social sphere increases and becomes more common. Of course, restructuring social finance is an important point for the reform and gives explicit short-run outcomes (avoidance of misallocation, containing costs), which are very relevant at this critical moment. But these measures could have an adverse impact in the long run. Financing health care and education only in proportion of 45% we can be sure that the morbidity and mortality will increase, holding back normal human development in Moldova. The same can be said about social benefits (pensions, compensations, indemnities), which form the main sources of income for the poor people. Cutting their size might affect directly the welfare of vulnerable groups, extending "poverty pockets". From this point of view the cost-saving approach cannot be justified as the single method to deal with reform of the social sphere.

Main Peculiarities of Conceptual Pattern in Reforming Social Sphere

<i>Classical Method</i>	<i>Case of Moldova</i>
1. Systemic approach 2. Trade off between efficiency- social equity-political feasibility 3. Strong stable financial support 4. Social cohesion of the community 5. Continuous improvement of practical performance 6. Unity in concept-policy-programs 7. Succession and continuity in the strategic line 8. "Policy window "is open 9. Equitable distribution of social costs	1. Unilateral approach 2. Rely on cost-saving methods 3. Financial unsustainability 4. Strong pressure from the opposition and community 5. Inconsistency in implementation 6. Discrepancy between concept and administrative capabilities 7. Fragmented and sporadic character 8. Tough political and administrative constraints 9. The burden of social costs is borne mainly by the poor groups

The principles of social sphere reform should satisfy the following three criteria: *economic efficiency, social equity, and political feasibility*. In the case of Moldova from the beginning the reform of social sectors was wrongly conceived, giving priority to financial aspects. Financial indices have been taken as an indicator of successful performance. Overlooking of modifications of the structure of benefits and the institutional network has caused substantial distortions during this period. Consequently, people's anxiety has been growing to the point of becoming an impediment to the reform. Trying to rectify errors made, policy makers have relied only on the distribution principle, which in our difficult situation deepens social polarization. As a result, fiscal evasion and income hiding (unregistered wages) become wider, threatening the future development of reform.

Undoubtedly, not all of what was done so far in the field of social reform can be seen as negative. There were some significant achievements. Of course, people want to benefit from the results of reform as soon as possible, and in a tangible form (increases in real wages and pensions, cheaper goods, accessible social services and others). Social changes, by their nature, *affect people's welfare today, but bring benefits after a certain period of time*.

Nevertheless there have been *some beneficial outcomes* from the social reform. It is worth mentioning in this context the availability of goods which has increased significantly during the 90s. This fact extended the choices and opportunities of people as consumers, reducing the time they spent in queues. The grade of imperfect substitutions, which is typical of the old economic system, has decreased. Market determined wages together with harder budget constraints have improved work incentives. Even if this deepens the differentiation in remuneration, the beneficial effect is significant: more productive and more qualified work has come to be paid higher than previously. At the same time the structure of peoples' income has changed substantially, driven by the market forces. The share of salaries in the total income has fallen from 74.5% in 1991 to 36.8% in late 1998, while the slice which comes from entrepreneurial activities increased. This fact has reduced the grade of dependency of income on salaries, making possible more flexible adjustment of wages level to the market requirements.

Although the progress registered in the education sector is still modest, we can find here some beneficial outcomes. They refer first of all to improved access to foreign know-how and the Internet. Additionally the opportunities to study abroad in prestigious western universities have increased. Slowly but consistently, private forms of education affirm themselves. In 1998 one out of five students was studying in the non-state private institutions. As a result, the financial sources of the educational system become more diversified. At the end of 1998 the non-state private sources of finance accounted for 10% of total expenditures for the education sector.

On the labor market occur processes which increase the flexibility of labor actors. Professional and territorial mobility has increased, which has a positive impact on the equilibrium between demand and supply of labor. Initiative and entrepreneurial talent becomes more significant for labor relations. The role of the private sector in creating new jobs is becoming more relevant. In the first half of 1998 about 1500 new jobs were created in enterprises with foreign and mixed capital, which is more by 1.4 times than in the private sector. Labor migration is increasing, although with some deficiencies. At present Moldova has bilateral conventions with Poland, Romania, Israel and many of the NIS regarding labor migration procedures.

Health care and medical assistance began the process of reform later than other social sectors. Ongoing restructuring has been dealing with all parts of this sector. For this reason it is too early to find some tangible benefits. They will be felt in the near future. For now we can mention the following results. The legislative pattern of reform was elaborated, which includes the Concept (adopted on July 17, 1997), law on compulsory medical insurance (approved on February 27, 1998), and a number of normative acts on restructuring the institutional network and optimization of expenditures. Gradually it is passing to the primary medical care through setting up the institution of family physicians.

In the field of social assistance, benefits still remain intangible, i.e. they do not have a clearly measurable value. The outcomes registered by now rather facilitate the promotion of reform, because their aim is to create a sustainable environment. In this sense we should mention phasing out some social facilities, tightening the eligibility criteria, improving the link between contributions and benefits. As a positive achievement could be mentioned the approval by parliament of the law on state pension insurance (October 14, 1998), and passage for examination of another set of legislative acts which will intensify the promotion of social reform. Unquestionably, a more realistic social fund budget, passed by the parliament, will exert a positive effect on the whole speed of reform.

The outcomes achieved so far could be considered as a first step on the long and controversial path of reforms. They indicate that the vector in general is set up properly. The real situation shows that the *most difficult part of this job still remains to be done*, as is indicated by the large gap between progress and planned objectives. Deterioration is typical for all social sectors. In health care, morbidity and chronic pathology are increasing sharply. The rate of maternal mortality still remains at a high level (48.3 per thousand). Each third child is born with pathologies at birth. In education the number of pupils which do not go to school for reasons of poverty is growing. In 1998 their number reached 10 thousand children, against 3900 in 1996. Huge salary and pension debts, accompanied by the poor collection of social contributions (15-20% of the daily necessity), complicate the situation which now faces the social sphere. Thus the implementation of measures that will improve the situation and also facilitate reform is urgently required.

Social Policy Agenda: priorities and succession. The vector of further actions should be oriented toward gradual reduction of social costs of economic reform and stopping the drop in living standards below the threshold of social security. Taking into account the scope of poverty, which affects almost 2/3 of the population, priority should be given to programs of poverty alleviation as the most important issue for the short-run period.

Social protection of the poor groups should be the main concern on the policy agenda for the next couple of years. Policy in this field could combine two elements: active measures and passive measures. In the first case the accent must be put on the promotion of economic opportunities for the poor by creating low paid jobs, diversifying the social infrastructure, and easing the access to credit. These could extend the possibilities of using more productively the only asset that the poor have in abundance - their labor force. In the second case significant progress could be achieved through the social assistance system network. Providing basic social services (access to elementary education, primary health care, nominative indemnities) would cushion to some extent the burden of social costs that is borne by the most vulnerable groups. For the passive policy and particularly for the poverty indemnities it is important to provide benefits on the basis of means testing, improving sharply their addressability.

With respect to the policy of reforming the social sphere we consider that reforms should be classified into short term activities (implemented as a matter of urgency), and activities for the medium term (strengthening the capability of social sphere). A hierarchical arrangement of priorities is not merely a theoretical exercise. It has significant pragmatic importance. Being implemented in a very turbulent environment and facing tough financial constraints, social policy thus feels the need to have a scale of social values. On this basis it should appreciate social dimensions of reform in order to avoid the dispersion and misallocation of resources. On the other hand this will allow to concentrate the efforts and limited resources on the most urgent problems, improving meanwhile the operational level of social programs.

The nature of *short term activities* confirms that they should be implemented in an operative regime and be oriented mainly to solving issues of a transitional nature which at the moment can undermine (or aggravate) substantially further promotion of social reform. These activities might have as a major objective the improvement of social finance viability, and could focus on the following:

- paying off overall pension and salary debt;
- avoiding a buildup in the current stock of pension and salary arrears and preventing it from occurring in the future;
- canceling the practice of payments in kind of pensions and salary;
- banning the use of netting transactions in relations with social fund;
- assuring timely payments of current pensions and wages with no arrears;
- increasing the level of contribution collection to the social fund, and tightening financial discipline;
- reducing former social privileges and improving the eligibility criteria;
- modifying the structure of social contributions in order to share more equitably

their burden between employers, employees, and state budget;

- assuring financing in full from the state budget for the minimum package of social services adopted by the parliament.

Medium term measures include a series of activities aimed at deepening the reform in all sectors of the social sphere. Their impact would have a long-run strategic effect and for this reason the benefits might be felt in the future, not immediately. The policy agenda for the medium term should cover in a balanced manner all parts of the social sphere activities, namely financial, structural, institutional, legal, and managerial concerning. Out of multiple strategic activities we might stress the following:

- building up a legislative pattern fitted to the requirements of the market economy;
- rationalizing the structure of social institutions and strengthening administrative capability.
- assessing the performance of social activities on the basis of western TQM standards;
- developing an alternative non-state sector for the provision of social services.

Implementation of social policy will happen in an unsustainable turbulent environment (at least for the short run). From this point of view some factors might cause difficulties to the normal running of things. These include:

- low rate of collection the social contribution.
- tough budget constraints which during the next period might become harder;
- weak administrative capabilities to implement the social programs;
- pressure exerted by the political opposition and the community might take larger proportions;
- weak political support from the parliamentary alliance.

Empirical evidence shows that the state play an important role in the promotion of social programs. Besides its traditional redistributive function the state maintain social cohesion in the society, facilitates the efficient promotion of market forces, and insures a minimum level of protection against social risks, which the private market generates. Following from this it is necessary to strengthen the role of public administration in the promotion of social reform. Today, after seven years of transition, we verify that the price of reform is too high, and this might substantially increase *social instability* in Moldova.