Deficiencies of the Public Pension System in Romania. Some Reform Measures Derived from the EU Experience

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Abstract. *The European Union is currently confronted with major economic and demographic changes that are challenging its ability to maintain strong social cohesion. Some possible solutions can be considered, such as increasing the employment for older workers and for women. In a comparative analysis for ten European countries, Romania has the lowest life expectancy, of 72.2 years, and the largest difference between life expectancy and standard retirement age, of 9.7 years. The private administrated pension funds can be a solution for labour market crisis from Romania; so recently there were adopted and implemented the regulations for this field.*

Keywords: public pension; demographic changes; old dependency ratio; multi-pillar pension system; European Union.

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JEL Codes: G23, J26.
REL Codes: 13C, 13K.

1. Introduction

According to 47[2] article from the Romanian Constitution, *all the citizens have the right for public pension, parental leaves, medical care in public units, unemployment benefits and other forms of social insurance, according to the specific laws.* In our opinion, the public pension represents a mechanism to reduce the uncertainty for person incapable to work. In Romania, the percent of public expenditures for public pensions and other social insurance benefits in GDP has increased to 7.3%, in 2008, the highest level after 1990, according to data provided by the National House of Pensions and other Social Insurance.

The basic principle for public pension is the solidarity between young generations, who works, financing the system and the older generation – who benefits for the social support according to the Law no. 19/2000. Unlike this mechanism, the basic principle for private pension is that the insured person will contribute during his active life in order to obtain his own pension. Considering the methods of long term savings and investment, the private administrated pension funds will have a significant influence of the contributor and of the entire Romanian economy, due to the following arguments:

- develops work place in this "industry";
- stabilizes [(1)] the capital market through their investments, unlike other types of participants, focused on speculative ones;
- through their funds, provides the necessary sum of money to finance the national economy.

According to Anghelache (2004, p. 20), the institutions which administrated the pension funds are legally considered institutional investors, realising significant transaction on the capital market.

The public pension reform takes into consideration, for the year 2009, the recalculation for special pensions [(2)], obtained by the diplomats, members of the Parliament, magistrates, the army personnel, the police officers, secret services, etc., according to the equality principle, set up on their annual score, on the same mechanisms which has already applied for the other categories of retired persons. For the police and army personnel, the current mechanism to calculate the pension is as a percentage varying between 60% and 64% (depending on the work conditions) to average monthly gross incomes from the last six month; and the standard age for retirement is 55 years. The average standard age for retirement for other social insured person from National Social Insurance Budget is around 62.5 years. Another advantage of this special professional category is the level of the individual percent of social contribution, of 5%, lower than standard level of 10.5%.

2. Social benefits from the Romanian public pension system

In Romania, the public pension system is represented by the social insurance, based on principles like protection and social security, for the active persons and for their family members. This system has as principal objective to develop and to assign the public funds for the active persons with partial or total loss of their work capacity or for those who has gone beyond an age limit.

Beside those pensions, the public authorities give to the Romanian social insured persons other benefits, such as:

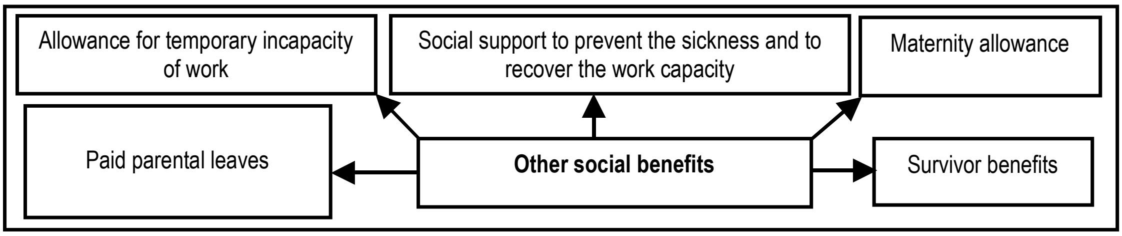

Figure1. *Other social benefits, according to the Romanian pension regulations*

Source: Own processing based on the regulations from Law no. 19/2000 for public pensions and other social benefits.

The Romanian public pension system can offer to the social contributors and their survivors, according to the law stipulations, one of the following types of pension:

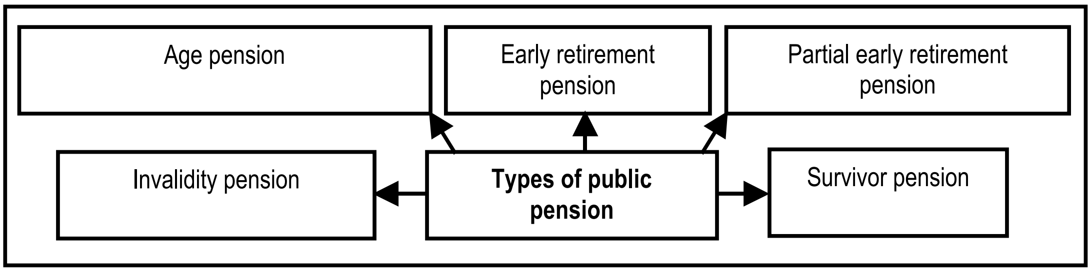

Figure 2. *Types of public pensions in Romania*

Source: Own processing based on the regulations from Law no. 19/2000 for public pensions and other social benefits (art.41-75).

1. Age pension. It is available for those social contributors who cumulative fulfilled, at the age of retirement, the standard age for retirement[3] (60 years for women and 65 years for men) and the minimum value of the contribution period (15 years both for women and men). The complete contribution period is higher for men: 35 years, compared with women: 30 years. Thus, the only principle which respects the equality principle is referring to minimum contribution period. From the total number of public pensioners at the end of 2008, those pensioners with age pension with complete contribution period represent 40.8% and those with age pension and incomplete contribution period represent 28.4%. We appreciated that the reduced proportion of the first category of age pensioners, compared with higher percentage of other types of pensioners, represents one of the most important explanation for the low amount of public pension.

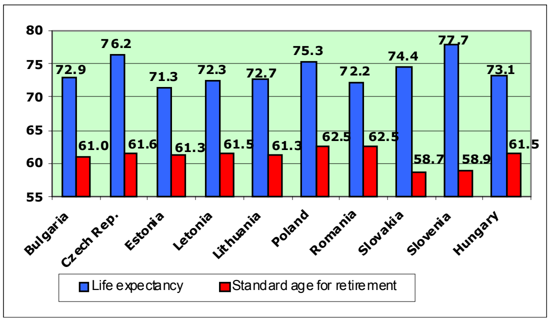

Figure 3. *Life expectancy versus standard age for retirement*

Source: Own processing based on data from Private Pension System Supervisory and from United Nations Development Programme.

For those countries with different level of standard age for retirement by gender, we realised an average between the two retirement age, in order to compare 10 European countries (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Poland, Slovakia, Slovenia and Hungary). The life expectancies for those citizens have major differences, the minimum value being of 72.2 years for Romania and the maximum one, of 77.7 years, for Slovenia. By the contrary, in Romania and Poland we have the highest standard age for retirement: 62.5, with the lowest value in Slovenia, about 58.7 years. The major difference between life expectancy and standard age for retirement, for those ten countries are in Slovenia (18.8 years) and the lowest difference is in Romania (9.7 years). Concluding, if all the insured persons from the public pension system from Romania will retire at the standard age, they will benefit for public pension for the lowest period of time, compared with the 9 European countries. A significant part of those insured persons will apply for other social benefits to retire sooner.

2. *Early retirement pension* is offered to the insured that have exceeded their full contribution periods by at least 10 years thus being allowed to pension maximum five years before they reach the standard pension age. When the anticipated pensioner will fulfil the legal condition for the age pension, the pension level will be recalculated, taking into consideration the assimilable periods and the contribution period from the anticipated periods. We appreciate as restrictive the conditions for early retirement pension.

At the end of 2008, the percentage of persons with early retirement pension was around 0.2% from the total number of public pensioners and this percent are decreasing because, at this moment, the insured persons cannot fulfil the cumulative legal conditions.

3. *Partial early retirement pension* can be taken by the insured that have completed the full contribution periods, and those who have exceeded the full contribution period by up to 10 years may claim the partial anticipated pension with a standard pension age reduction by maximum five years. At the end of 2008, the percentage of persons with partial early retirement pension was around 2% from the total number of public pensioners and this percent are increasing, especially in the actual context of economic crisis.

4. *Invalidity pension.* Invalidity pension shall be entitled to the insured who have lost, totally or at least half of their work-capacity, due to: (i) occupational accidents, according to the law; (ii) occupational diseases and tuberculosis; (iii) ordinary diseases and accidents which are not related to work. Depending on the requirements of the job and degree of work-capacity loss, there are three degrees of loss of the work-capacity.

The insured that has lost work-capacity due to ordinary diseases or accidents which are not related to work shall benefit from disability pension if they complete the required contribution period with respect to age.

At the end of 2008, the percentage of persons with invalidity pension for the first degree was around 0.8%, those with the second degree of invalidity pension around 10.1% and those with the third degree around 5.6% from the total number of public pensioners.

Tănăsescu, Şerbănescu, Ionescu, Popa and Novac (2007, p. 96) considered that *the number of pensioners increased fourth times in 15 years (…), the invalidity pension being one of the most used alternative to unemployment.* In this context, the public authorities pursue to reduce the number of beneficiaries of invalidity pension, especially due to the fact that the majority are persons able to work.

5. Survivor pension. Beneficiary may receive a pension along with income from a professional activity, if the gross monthly income is not higher than one quarter of the average gross wage. The children and the surviving spouse shall be entitled to a survivors' pension, if the deceased was a pensioner, or he satisfied the terms for obtaining a pension. The level of this type of pension will be established as a percentage to average annual score realized by the deceased, differentiate function of the number of survivor persons, as it follows:

a) for one survivor - 50%;

b) for two survivors - 75%;

c) for three and more survivors - 100%.

At the end of 2008, the percentage of persons with survivor pensions was around 12.1% from the total number of public pensioners.

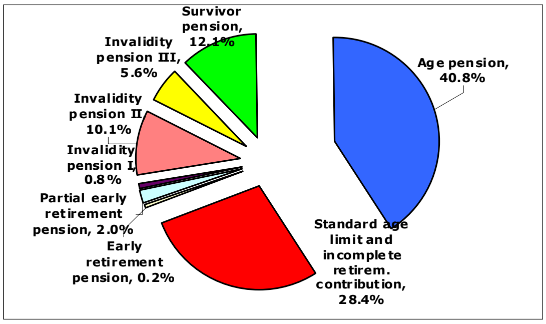

Figure 4. *The percentage of each type of public pensions, at the end of 2008, in Romania*

Source: Own processing based on data from the Ministry of Labor, Family and Social Protection.

Thus, at the end of 2008, less than a half from the total number of retired persons, cumulative, fulfilled the two legal conditions for a public pension: the standard age limit and the contribution period.

3. Statistics regarding the Romanian public pensions system

The great proportion of people retired in a different way than carrying out the age limit and the complete length of service constitute a weakness for the Romanian public pensions system.

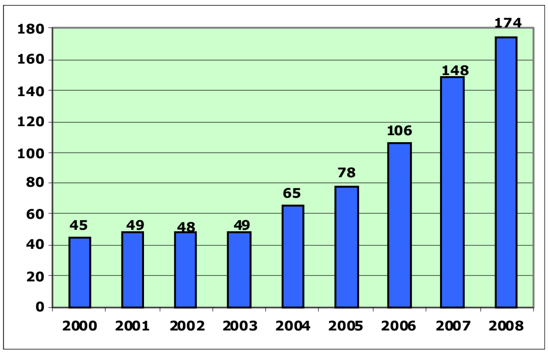

Figure 5. *The evolution of the average net public pension in Romania in Euro*

Source: Own processing based on data from the National House of Pensions and other Social Insurance.

It can be observed that the average monthly level for public pension had an ascending trend, starting from a minimum value of 45 Euro in 2000 and reaching to 174 Euro at the end of 2008, thus an increase of 287%. This increasing trend has multiple reasons:

- retirement point value increase[(4)] starting from 159.7 Ron in 2001, reaching to 697.5 Ron in 2008;
- the enlargement of the social insurance contributions collecting base[(5)] – due to: (i) the continuous changes in the fiscal regulations; (ii) the economic growth, which had induced the increase in the number of tax contributors and in their gross incomes;
- the decrease percent of the social insurance contributions[(6)] from 35% in 2001, to 27.5% in 2008, which has been compensated through a better collection due to the switch of this duty from the specific ministry to the National Agency of Fiscal Administration.

The pension conversion in a widely used and reserve international currency will diminish the negative influence, which had the price increase on the real pension value.

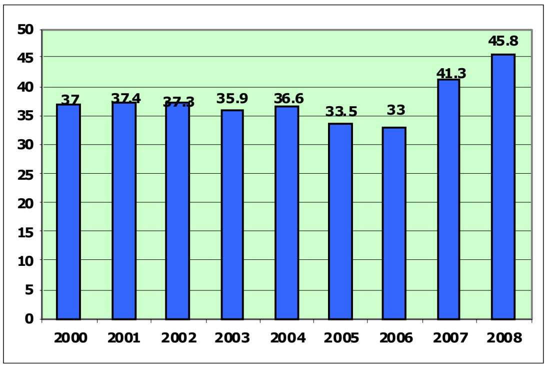

Figure 6. *Net public pension as a percentage of net average income (%) in Romania*

Source: Own processing based on data from the National House of Pensions and other Social Insurance.

If we analyze the ratio between the net average monthly public pension and the net average wage (%) in Romania, we can observe the minimum value of 33% in 2006 and the maximum value of 45.8 % in 2008. The recently ascending evolution of this variable is due to the increase of the retirement point value. This index is appropriate to compare the pensioners' living standard versus the active population, at different moments in time. Thus, the pensioner net average income decreases to a less than a half comparing to the moment when he was an employee.

Tănăsescu, Şerbănescu, Ionescu, Popa and Novac (2007, p. 99) said that is a conflict among generations, *because the active population is witness to the continuous pressures from the pensioners to increase the level of public pension, without any direct relation with the former social contributions. In this context, we have considered as necessary to analyse how has been evolve the dependence ratio in the public pension system*. For the Romanian case, we calculated this index by dividing the number of the retired persons to the number of employees, at the end of each year.

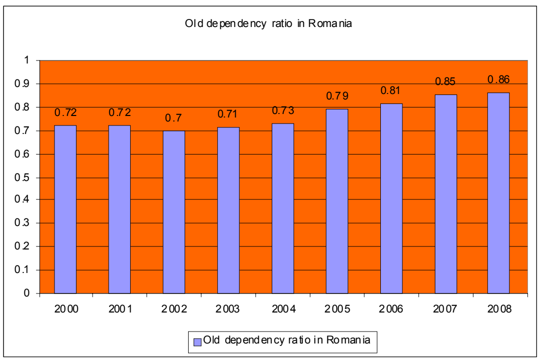

Figure 7. *The old dependency ratio in the Romanian public pension system*

Source: Own processing based on data from the Ministry of Labor, Family and Social Protection.

At the end of 1989 almost four employees had sustained a pensioner, but at the end of 2008, 0.86 employees sustain a pensioner, and the most difficult situation was at the end of 2002, when the dependency ratio was around 0.70. We found that the reasons for this fact are: (i) the early retirement by the public authorities for certain professional categories, to avoid the unemployment or social conflicts; (ii) the emigration of a significant part of the active population; (iii) the decrease in the population number, etc. For improving the specific pension system situation, there have been implemented the laws regarding the private pensions, so that in Romania will coexist the public pension system and also the mandatory and voluntary private pensions funds (the multi pillar pension system which has been proposed by the World Bank).

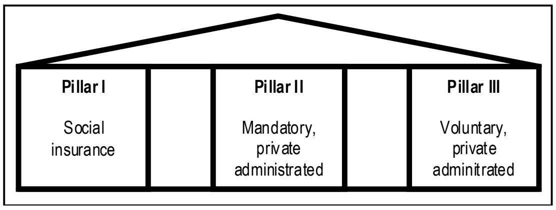

Figure 8. *The multi pillar pension system*

Source: Own processing.

The public pension system "pay as you go" with defined benefits has the main purpose to prevent the old people social difficulties and to spread the risks among generations. The Romanian pension's reform should carry out two imperative requirements: not to endanger the pension payments for those who are entitled to receive them and to allow the employees choosing to remain in the old system or to invest their contributions in the private pension funds. One of the World Bank requirements for ensuring the social insurance budget financial sustainability is to equalise the retirement age for the men and women – at 65 years.

The private pensions system – with defined contributions – has the main advantage to diminish the black market labour, as the employees would like to be hired by using official contracts, this way being aware that the money will gather in their individual accounts, and indirectly the public budget will collect more by increasing the collecting base.

Every employee pays a monthly contribution – calculated as a certain percent of his salary, during his active life to the 2nd pillar and to the 3rd pillar, for gathering his own pension. These contributions are invested on the financial market which increases their value over time; even if in certain moments the negative effects of the economic cycles may decline the individual account value. Thus, the money will be invested more efficient for the individual than in the public field and the employee will receive at the retirement a larger amount than if he pays equal at the 1st pillar. The employees will consider their deposits as savings, and the social insurance contribution was just a duty. This fact will generate a change in the attitude for every employee and this will be motivated to work harder and more efficient to have a higher pension.

4. The social situation in the European Union: present and perspectives. Some reform measures implemented on the European labour market

The European Union is currently confronted with major economic and demographic changes that are challenging its ability to maintain strong social cohesion. Following a period of considerable employment growth, the labour market situation deteriorated in an unfavourable economic environment marked by much weakened economic growth in most Member States. These trends pose a number of challenges and underline the importance of making the most of the opportunities for improving Europe's economic and social performance. In particular, as suggested by the Commission's Green Paper "Confronting demographic change and a new solidarity between the generations", a new intergenerational balance that invests in the young, that provides more support to families while encouraging the older generations to remain active could generate more social cohesion and increase the Europe's economic performance(7).

Three factors are causes for Europe's ageing society: low fertility rates, extended life expectancy, and a baby-boom generation that is reaching retirement age; together with other factors, such as unemployment and changes in the duration of the average working life, the age structure of society impacts on the numerical balance between persons not working compared with those in work. Future demographic trends are likely to see a sustained increase in the proportion of the EU population that is aged above the current retirement age of 65(8). The European Commission's Green Paper raises questions such as: how can the decline in population be reversed? or how can society manage with the impact of an ageing population, while providing opportunities to the youngest members of society?

Age dependency ratios are important demographic indicators that relate the young and old age population to the population of working age. The young age dependency ratio is defined as the population aged up to 14 years related to the population aged between 15 and 64 years; the old age dependency ratio as the population aged 65 years or older related to the population aged between 15 and 64 years and the total dependency ratio is defined as the population aged up to 14 years and aged 65 years or older related to the population aged between 15 and 64 years. According to the Eurostat yearbook 2008, combining these indicators, the total dependency ratio in 2005 ranged from 46.6% in Europe to a high of 81.2% in Africa, where the vast majority of dependents are children. In Europe the fall in young age dependency has been counterbalanced by an increase in old age dependency, as a result the net change in total dependency has been relatively small in comparison to the most other continents, necessitating a switch in social expenditure to more healthcare and pensions for the elderly.

While old age dependency ratios are expected to increase considerably, young age dependency ratios are projected to remain almost unchanged, raising only slightly as a result of modest increases in fertility in a number of Member States. The total dependency ratio of the EU-27 is projected to increase from 48.8 % in 2006 to 77 % by 2050. This means that whereas in 2004 there was one inactive person (young or elderly) for every two persons of working age, in 2050 there would be three inactive persons for every four of working age. The growth of the population aged 80 or more will be even more pronounced as more people are expected to survive to higher ages. The proportion of very old people (aged 80 and more) is projected to almost triple in the EU-27.[(8)]

Demographic ageing is inevitable and the best response to its economic and social consequences is to increase labour force participation, particularly of older workers and women. Increased female labour force participation could, however, have consequences on fertility and hence on the longer term demographic development of the European Union. The question thus arises as to how female labour force participation may be increased while improving current fertility trends at the same time.

The greying of the population will put downward pressure on labour supply, with negative implications for material living standards and public finances. Increasing female participation could partially help resolve this problem. Policies helping women to reconcile work and family life are also politically more acceptable than policies aimed at maintaining older people longer in work (Burniaux et al., 2003).[(9)]

In her OECD study Jaumotte (2003, p. 7) assess the role of various factors in determining the pattern of female participation rates in OECD countries. A number of policy instruments are included in the analysis, such as the tax treatment of second earners (relative to single individuals), childcare subsidies, child benefits, paid parental leaves, and tax incentives to share market work between spouses. The role of other determinants, such as female education and labour market conditions, is also considered. The econometric study takes into consideration 17 OECD countries over the period 1985-1999.[(10)]

First, policies which stimulate female participation include a more neutral tax treatment of second earners (relative to single individuals), tax incentives to share market work between spouses, childcare subsidies, and paid parental leaves. Childcare subsidies and paid parental leaves tend to stimulate full-time participation rather than part-time participation. However, taking parental leave for an extended period of time may deteriorate labour market skills, and damage future career paths and earnings. Beyond 20 weeks, the marginal effect of additional parental leave on female participation becomes negative.

Second, contrary to childcare subsidies, child benefits exert a negative impact on female participation, due to an income effect and their lump-sum character. Child benefits increase the disposable income of families with two children on average by 7.5 per cent. In a number of countries this increase amounts to between 10 and 20 per cent and some of these countries have significantly increased spending on child benefits over the past decades.

Third, the availability of part-time work opportunities also tends to raise participation, at least in countries with a strong female preference for part-time work. But, when part-time working entails a wage penalty, low social security coverage, job insecurity, and little training, it risks marginalising women in these jobs. In such instances, policy should aim at fostering better access to full-time jobs, or reduce the negative future career consequences of a period spent in part-time work.(10)

Finally, female education, low unemployment rate on the labour market and cultural attitudes are important determinants of female participation, too. The education choice of a woman will influence her future career prospects and in particular on the policies which would help her reconcile work and family life. Where these policies are more developed, women should be more likely to invest in their education.

Taking into account the second instrument to control the demographic ageing, identified as solution for the European Union's labour market challenging – the increase of the employment rate for older workers, it can be remarked that the demographic pressure on pension systems is expected from Eurostat to nearly double from 2004 to 2050 (from 25% to 53%). It is essential to accelerate the increase employment rates among 55-59 and, in the longer term, to increase employment rates among 60-64 in order to ensure the future adequacy and sustainability of pension systems.(11)

According to study published by the Social Protection Committee (2008), in the European Union the share of inactive (for sickness or other reasons) increases significantly from the age bracket 50-54 to the age bracket 55-59 and then remains roughly constant in the age 60-64 before declining slightly from 65. Only about half of older workers leave their last job or business to take up a pension: about 55% take up directly a pension or an early pension. They also often leave for either unemployment (13%) or long term sickness or disability (12%). At higher ages, the share of older workers who leave their last job or business to take up a pension increases regularly, while the share of those leaving for unemployment decreases sharply, as does long term sickness or disability to a lesser extent.

Exits through direct pensions are particularly low in some Member States (notably Belgium, Estonia and Cyprus). The share of exits through unemployment lies at around 15% on average and is rarely lower than 10% and can exceed 25% (Denmark, Estonia, France, Lithuania, Portugal, Finland and Sweden). The share of exits for long term sickness or disability is also generally around 15% (it is lower than 5% in Italy, Cyprus and Latvia and around or often higher than 25% in Estonia, Ireland, Hungary, Lithuania and Finland). The main reason for retirement or early retirement among 50-69 is having reached statutory retirement age (about 40%), which clearly increases with age brackets. For about 10% this is related to difficulties in the labour market (job loss 7% or problems related to job 2%), similar to reasons linked to health difficulties (own health or disability 12% or care responsibilities 2%). About one third declare a main reason linked to favourable financial arrangements to leave (9%) or a preference to stop working (20%). (11)

The recent improvement in the employment situation of 55-64 also coincides with a growing divergence between Member

States, indicating slower progress for some groups (men *versus* women, higher educated *versus* lower educated). In Romania, this trend is not quite clear; for example, for a company which will employ an unemployed person – graduate or a person with an age over 45, according to the Romanian specific law, more incentives, as number and values, are received for graduate than the older worker. The multiplicative coefficient, applied to social reference indicator, is 1.5 for graduate and only 1 for older worker.

Most Member States are engaged in reforms to adapt these schemes and reducing the take-up of early exit benefits. Reforms are focused on the design of unemployment, early retirement benefits and access to disability pensions and rehabilitation. Some Member States have also reviewed taxation and the design of private pensions. Caused by the actual financial and economic crisis, the Romanian Government initiated two measures: to prolong, from 12 month to 15 month the period for unemployment benefits and the attempt to eliminate the possibility to obtain, in the same time public pension and salary, for those persons working in the public system. These two measures cannot be integrated in the European Union's trend for adapting the macroeconomic policies to the new challenges because will maintain with three more months outside the labour market some active persons and, on the other hand, will encourage early exits for older workers, especially for those with more skills and a grater level of education.

More steps will be needed in a number of Member States in order to achieve more systematic reforms to create labour market opportunities for older workers and less skilled ones as they can be less employable. Retraining and preventing early retirement by improving workplace health and safety standards are necessary, too.

Acknowledgements

This research was supported by the Romanian Ministry of Education and Research – the National Authority for Scientific Research (NASR) through National Programme Ideas (PN II), Grant No. 1831 / 2008.

Notes

(1) It is possible that the decreasing in the stock prices listed on the Bucharest Stock Exchange, during the period 2007 – 2009, to be less detrimental if on the Romanian capital market would exist significant investments from the private administrated funds, having as more important objective long term investments and lesser speculative ones.

(2) At the end of 2008, Romania had approximative 200.000 beneficiaries of special pensions.

(3) Romania has a transition period, until March 2015, to raise the retirement age limit, the complete contribution period and the minim contribution period. Otherwise, it would be existed an empty space of three years with no retired persons.

(4) The decision is a political one, when the Government or the Parliament adopts laws. Analysing the regulations issued in this domain, we can observe that, in this period of time, we have five laws, 14 Government Resolution, four Emergency Government Ordinance and two Government Ordinance. Thus, the Romanian Government acted both as executive and legislative authority.

(5) If, in the first place, this was represented by the regularly income of the social insured persons, minus the income with it was not stipulated in the individual or in common work contract, at the end of the period it was represented by the gross income of these contributors.

(6) For normal work condition.

(7) According to European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities, "The social situation in the European Union 2005-2006; Overview", 2007.

(8) See "Europe in figures", Eurostat yearbook 2008.

(9) See Burniaux, J.-M., R. Duval, and F. Jaumotte, "Coping with ageing: a dynamic approach to quantify the impact of alternative policy options on future labour supply in OECD countries", *Economics Department Working Papers No.371*, 2003, OECD.

(10) According to Jaumotte, F., "Female Labour Force Participation: Past Trends and Main Determinants in OECD Countries", *OECD Economics Department Working Papers*, No. 376, 2003, OECD Publishing.

(11) See The Social Protection Committee, "Promoting longer working lives through pension Reforms. Early Exits from the labour market", February 2008.

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Legea nr. 19/2000 privind sistemul public de pensii și alte drepturi de asigurări sociale

Legea nr. 164/2001 privind pensiile militare de stat

Legea de revizuire a Constituției României nr. 429/2003

Legea nr. 179/2004 privind pensiile de stat și alte drepturi de asigurări sociale ale polițiștilor