

## CAUSES ANALYSIS OF THE DEFICIENT PUBLIC PENSION SYSTEM IN ROMANIA

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### Summary

The corrections frequent in the public pension system have not removed the imbalances that accumulate in the allocation of resources among different generations in the same generation. State deficits accumulated deficit explicit and implicit public pension system that otherwise not calculated, thus transferring the financial burden on future generations, without giving a proper solution even for the present. Financial deficits are not the result solely of the dependency and emigration, but the account of how the scheme works- pay-as- you-go.

Pension schemes pay-as-you-go, based on solidarity between generations, are facing increasing in providing decent pensions. This is largely due to the decrease in the number of taxpayers and increase the number of pensioners while aging population with declining birth rates, increased life expectancy, early retirements.

If personal savings of individuals would be sufficient to ensure an adequate income in retirement, it would not be necessary plans. Anyway, for a large part of the population is difficult to save due to low incomes, unemployment, inflation and uncertainty about the rate of return on different investments. Even with the existence of a public pension system, when there is a dramatic reduction in retirement income, without, however, as the costs to diminish. As a result, the standard of life that each of us typically is difficult, if not impossible, to maintain.

Today in Romania, each taxpayer maintains more than one retiree, this report will come as a taxpayer to maintain more than 2-3 retired by 2050.

**Key words:** causes, public pension, deficient, system

**Clasification JEL :** A, A1

## 1. Introduction

The objective of this paper is to present the main problems and analyze specific cases as deficits facing public pension system in Romania.

It should be noted that the current system does not allow the accumulation and investment of amounts collected. Everything that is collected is used to pay pensions. Thus, there is no certainty that when the taxpayer reaches retirement age, the state will have the financial resources necessary to ensure a decent pension.

It is necessary to move from a system based on solidarity and redistribution of revenues to a new system based on their savings and investments.

World Bank supports and promotes the reform of pension systems in the countries it works with. System promoted by the World Bank, who is deployed in Romania, is based on three main pillars.

Table . 1 - The pension system in Romania

| Pillar I                                          | Pillar II                                                                                                                                                                                                    | Pillar III                                                                                               |
|---------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| <b>It is the Public pension offered by system</b> | Represents private pensions - mandatory private pensions                                                                                                                                                     | Represents voluntary private pensions, consisting of additional contributions of employees and employers |
| <b>Is the state pension</b>                       | Pillars II and III suppose private management of pension funds. Many countries have adopted this system: Poland, Czech Republic, Slovakia, Chile, Bulgaria, South Korea, Thailand, New Zealand, Turkey, etc. |                                                                                                          |

## 1. The current situation of the pension system in Romania

The current pension system is considered one of all major "difficulties" that sinks the Romanian state budget, this year there are only a very large deficit. At actual cash in Romania there are 4.7 million workers who pay 5.7 million retirees, leading to a significant imbalance, just because there are more people receiving pensions and fewer employees.

Given that the number of retirees increases, and the number of people employed decreases, the system faces problems to people with decent pensions. Last pension reforms, abolishing the privileges of certain categories of pensioners, do not contribute substantially to improving the overall situation. Annual indexation of pensions does not correspond to economic realities and does not cover the required minimum. The current pension system works carrying with it a whole series of problems in the past, and sustainable growth can be achieved by the addition of private pensions in the public pension system in Romania.

This gradual reduction in the number of workers adversely affect the public support and an alternative to privately managed system is not only necessary, but mandatory.

In the second quarter of 2013, the average number of retired persons was 5,413,000, a decrease of 80,000 persons compared to the same quarter of the previous year with 20,000 persons compared to the first quarter 2013 average monthly pension was in the second quarter of 2013 £ 807, up 4.9% from the same quarter of the previous year and 1.5% over the first quarter of 2013 .

Table . 2 -Number average pensioners and average monthly pension after system retirement

|                                       | Average number<br>- housand person - |             |                | The average pension<br>- Lei per month - |               |                |
|---------------------------------------|--------------------------------------|-------------|----------------|------------------------------------------|---------------|----------------|
|                                       | TR. II<br>2012                       | TR. I 2013  | TR. II<br>2013 | TR. II<br>2012                           | TR. I<br>2013 | TR. II<br>2013 |
| I. Social insurance                   | 5486                                 | 5426        | 5407           | 770                                      | 796           | 808            |
| in which:                             |                                      |             |                |                                          |               |                |
| - social insurance                    | 4703                                 | 4683        | 4679           | 778                                      | 800           | 812            |
| II. Welfare recipients - type pension | 1                                    | 1           | 1              | 194                                      | 200           | 203            |
| III. I.O.V.R.                         | 6                                    | 6           | 5              | 238                                      | 235           | 234            |
| <b>TOTAL I+II+III</b>                 | <b>5493</b>                          | <b>5433</b> | <b>5413</b>    | <b>769</b>                               | <b>795</b>    | <b>807</b>     |

Source: National Institute of Statistics<sup>1</sup>

According to data analyzed is noted that currently retired persons holding the largest share (99.9%) in the total number of retirees and pensioners welfare state is 86.5% of the total social security.

The average pension of state social insurance was £ 812 in the second quarter of 2013, significant discrepancies in territorial, so the difference between the minimum and maximum value exceeding £ 350 (650 USD in Giurgiu to 1026 lei in Bucharest <sup>2</sup> ).

Table .3 - Numărul mediu al pensionarilor de asigurări sociale și pensia medie lunară pe principalele categorii de pensii

| Categories of pensions      | Average number<br>- housand person - |             |                | The average pension<br>- lei per month - |               |                |
|-----------------------------|--------------------------------------|-------------|----------------|------------------------------------------|---------------|----------------|
|                             | TR. II<br>2012                       | TR. I 2013  | TR. II<br>2013 | TR. II<br>2012                           | TR. I<br>2013 | TR. II<br>2013 |
| 1. Old age                  | 3934                                 | 3929        | 3925           | 873                                      | 900           | 914            |
| 2. Early retirement pension | 11                                   | 12          | 13             | 942                                      | 958           | 994            |
| 3. Partial early retirement | 115                                  | 106         | 102            | 644                                      | 631           | 636            |
| 4. disability pension       | 794                                  | 755         | 746            | 561                                      | 572           | 579            |
| 5. survivor pension         | 632                                  | 624         | 621            | 412                                      | 431           | 439            |
| <b>TOTAL 1+2+3+4+5</b>      | <b>5486</b>                          | <b>5426</b> | <b>5407</b>    | <b>3432</b>                              | <b>3492</b>   | <b>3562</b>    |

Source: National Institute of Statistics

<sup>1</sup> NATIONAL INSTITUTE OF STATISTICS - Press release no. 223 of September 13, 2013<sup>2</sup> NATIONAL INSTITUTE OF STATISTICS

Regarding the categories of pensions for the number of age pensioners were predominantly (72.6%) in the social insurance pensioners and retirees enrolled in pension categories - anticipated and expected part - represented 2.1% .

## 2. The causes of current deficits recorded in the public pension system in Romania

All over the world pension system is undergoing a period of crisis, which is accentuated by the aging population, the decline in life expectancy, a declining birth rate and the reduction of the working population and the international migration of labor has become a phenomenon.

2007 was the last year's state budget Social insurance was in balance. This means that the entries of insured and employers' contributions were equal to expenditure. Since 2008, deficits in the system began to be increasingly higher. The present study will attempt to analyze the causes of this deficient and ineffect, watching and analyzing existing data from the beginning to the present.

The causes the current deficits of the pension system in Romania could be:

-the introduction of pillar II pension guaranteed minimum pension, retirement from the army and police and reducing wage labor migration abroad, early retirement pension fraud in cases of disability and increased much more than 10% of GDP allocated to pay pensions. Many European Union countries, including Romania, have high costs of between 5 and 10% of GDP in some countries even more to provide the financial resources necessary to pay pensions.

### The introduction of the second pillar of pensions<sup>3</sup>

Pillar two of pensions CAS involves transferring a percentage of young workers (under 35 years required between 35 and 45 years optional) to private pension funds. This percentage was 2% share of contributions to the pension system at the start of collection action, planning to gradually increase to 6%, with an increase of 0.5% per year. Action collection began in January 2008.

In 2008, therefore, 4.53 million people have contributed to private pension funds. The number has increased in the coming years, as follows: in 2009 there were 4.91 million people in 2010, 5.19 million, and in 2011, we have 5.34 million contributors.

Against the background of diminishing revenues from CAS, Pillar II payments made on account deficit increased current public pension system

Table 4: Evolution of the Pillar II of pensions transfers

| Years | Sum of transferred to Pillar II (lei) |
|-------|---------------------------------------|
| 2008  | 821.977.642                           |
| 2009  | 1.324.924.385                         |
| 2010  | 1.504.017.375                         |
| 2011  | 1.980.000.000                         |
| 2012  | 2.724.200.000                         |

Source: State social security budget execution

Table 5: Share of transfers to Pillar II budget deficit of social insurance

| Anul | Transferuri % |
|------|---------------|
| 2008 | 59,5%         |
| 2009 | 20,71%        |
| 2010 | 14,27%        |
| 2011 | 13,49%        |
| 2012 | 19,69%        |

Source: State social security budget execution

From the data analyzed is seen, therefore, that in 2008, into the collection of contributions to the second pillar pension transfers to this pillar had a higher percentage rate in the state social insurance budget deficits (59.58%). At

<sup>3</sup> Valentin M. Ionescu - public pension reform: - Document in the work

that time it was the main cause of the deficit. In the following years, the share of transfers declined, reaching 13.49% in 2011.

The 3.5% increase in the contribution to the second pillar, in 2012 the share of total transfers to this pillar, the total deficits of the state social insurance system was 19.69%.

On 30 June 2014, 6.16 million people were registered as participants in the privately managed pension system (+ 2.02% compared to December 31, 2013).

Of the 6.16 million people registered, approximately 190,000 people had no contribution paid by the beginning of Pillar II in Romania (May 2008), the number of participants with at least one contribution being 5.97 million.

#### **The introduction of minimum guaranteed social pension / social pension (art. 7 of Law no. 118/2010)**

In order to ensure minimum subsistence income for some of the retired public pension system in February 2009, the Government issued Ordinance No. 6/2009 on the establishment of minimum guaranteed social pension, renamed by Article 7 of Law No. 118 / in 2010. According to GEO No. 6/2009 Social Benefit retirement benefit public pension system residing in Romania, where the amount of their pension is below the allowance, the amount of which was fixed at 350 lei (Article 7, paragraph 2 of Law No 118/2010).

In 2011 it fell under the provisions of this Ordinance, a total of 409,364 pensioners and 208,735 retired public system farmers. Mean supported by the state budget was £ 91 for the former and 85 lei for former farmers, according to data from the National House of Public Pensions. Extrapolating data from the first half of 2011 (latest available data) for the year, we obtain a value of 659,935,188 likely lei, which is the fiscal effort to support this type of social allowance.

Analyzing the financial impact of this measure on state social insurance budget deficits is found Canum 2012 expenses related to the introduction of social benefits for retirees have a weight of approx. 4.5% deficit of the pension system and the 2013 provisions are made a higher deficits.

#### **Increasing the number of pensioners<sup>4</sup>**

Will not be ignored contractions were recorded in the 90's in various market segments, especially in industry and led various governments to try social mitigation. However, the evolution of the number of pensioners was influenced by state intervention, without an impact assessment. We list the political decisions that early retirement was followed in 1990 by - Law No. 60/1990, or integration in the public pension system retirees cooperatives (Law No. 34/1993). To these were added due to restructuring measures and a number of regulations relating to special pensions. These public policies have stimulated labor market exit of a large number of people and led to increased public spending without any compensation manageable side income due to fluctuating economic development and immigration phenomenon that has displaced labor to countries industrialized.

Because regulations quantified reached the average age to be present 63 years for women and 65 for men is increasing initial retirement at age 54 years (considering regulatory action gradual deficit ).

#### **Raising pensions**

The value of the average pension increased in the last three years by more than 7% to £ 809 per month, which means that in real terms, pensioners have experienced growth due to inflation

An interesting situation shown by the difference in values of old age pensions and early retirement pensions (which are not more than five years before the statutory retirement age and requiring a minimum contribution period of eight years) in the last three years, beneficiaries of early retirement have higher pensions than pensioners who came to the statutory retirement age. In the third quarter of this year, the average pension for retired category age limit was £ 915, and the early retirement was 992 lei.

Table 6 Evolution of the average number of pensioners trimistrul III the last three years, by category (thousand)

| Years                      | 2011         | 2012         | 2013         |
|----------------------------|--------------|--------------|--------------|
| <b>TOTAL of which:</b>     | <b>5.568</b> | <b>5.462</b> | <b>5.395</b> |
| ➤ Old age                  | 3.940        | 3.932        | 3.923        |
| ➤ Early Retirement pension | 10           | 11           | 14           |
| ➤ Partial early retirement | 127          | 111          | 100          |
| ➤ Disability pension       | 844          | 777          | 738          |
| ➤ Survivor pension         | 647          | 631          | 620          |

Source: National Institute of Statistics

<sup>4</sup> Valentin M. Ionescu - public pension reform: - Document in the work

Table 7 - Evolution of the average pension in the third quarter over the last three years, by category (USD / month)

| Years                      | 2011       | 2012       | 2013       |
|----------------------------|------------|------------|------------|
| <b>TOTAL of which:</b>     | <b>758</b> | <b>772</b> | <b>809</b> |
| ➤ Old age                  | 862        | 847        | 915        |
| ➤ Early Retirement pension | 962        | 933        | 992        |
| ➤ Partial early retirement | 677        | 632        | 627        |
| ➤ Disability pension       | 564        | 560        | 576        |
| ➤ Survivor pension         | 394        | 415        | 440        |

Source: National Institute of Statistics

According to data analyzed Note that pensions have increased by more than 7% in the last three years, and 70,000 fewer retired last year.

The pensions deficit budget was 3 billion last year and the first three quarters of this year has begun to decline, precisely because of a significant number of pensioners and increasing revenues from social contributions.

More restrictive early retirement, eliminate fraud among disability retirement and raising the retirement age has led to a decrease in the number of retired state social insurance in the last three years

#### **Reducing salaries**

Before cutting salaries by 25%, the average wage in the public sector was £ 2108 and dropped to 1,701 lei, as a result of Law 118/2010.

So calculating that by reducing salaries by 25%, decreased the average gross salary for 1,266,550 people with £ 407 results in a decrease in social security contributions in the last six months of 2010 approximately 161,347,071 lei per month, 968,082,426 USD for the whole year, with the landmark contribution of 31.3% of gross salary, which is divided between the employee (10.5%) and employment (20.8%). That figure represents 8.84% of the total deficits for 2010, which leads to the conclusion that cutting salaries had a major impact on the pension system.

Increasing salaries by 15% in early 2011, followed by an increase of 8% in the summer of 2012 mitigates the impact of falling salaries in 2010 in nominal terms.

Starting with the date of July 1, 2014, the gross minimum wage guaranteed payment is set at 900 lei per month. Minimum wage from July 1 involves additional costs for employers. More specifically, they pay extra for the month 64 lei per month for each employee paid minimum wage.

#### **Migration - a destabilizing factors**

Massive migration abroad and unemployment adversely affects the pension system. In the years 2005-2013, the number of employed people decreased by 11%, the most affected are young people up to 24 years.

According to statistics, in the last 50 years the share of the population increased retirement twice, while the number of children under 14 years halved. The reduction of new entrants in the labor force threatening the sustainability of the public pension system existing model today. In the coming years is expected gradual increase in the population of retirement age. Raising will be 2-2.5% annually, and by 2020 the population at retirement age will increase by 25 percent compared with 2010.

## **Conclusions and recommendations**

If no measures are taken in three to five years, the pension system will ruin. The number of pensioners, decreases the number of employees and in the absence of policies to create jobs and stimulate the private sector as it contributes in taxes to support the pension fund, the system fails. If seven years ago there were 450,000 pensioners in 2015 their number will increase by 30,000. Meanwhile, the number of people who work in the last ten years has decreased by 400,000 and decreases each year.

In my opinion I think that increasing the number of jobs should be a national priority. Just so we can have a balanced budget in all respects, not only in terms of the pension budget.

Some of the strategies to solve the problems facing public pension system aimed at trying to reduce the number of recipients of benefits, increasing the retirement age gradually, restricting access to certain types of retirement - such as invalidity pension where have introduced stricter criteria for access, and access to early retirement, which were greatly increased rates of penalty.

Another phenomenon that could destabilize the pension system is the informal economy, which in the last decade between 30% and 38%. This phenomenon is characterized by avoidance employer to terminate employment contracts, non-registration of employees as contributors to social funds, tax evasion, undeclared and declared

incomplete income or double accounting. Informal activity is one of the essential characteristics of the private sector and virtually not found in public areas.

Taking into account the future value of money, who pays social contributions state today does not receive the same amount in the future by the promised pension, which meant that some of its own income confiscated, shrinking them is both present welfare by paying contribution of income and future well-being, based on a promise. For this reason, those who argue that the state must respect the right to a pension only, not an actual payment equivalent to contributions paid, commit an error of law.

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