

## PROPOSAL REGARDING THE REFORMATION OF THE ROMANIAN PUBLIC PENSION SYSTEM

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### **Abstract**

*The social insurance system from Romania, reformed continuously since the 90's, is undergoing a period of serious crisis, with huge and growing deficits, while being far from the principle of social reasonability. Similar situations are found also internationally. The paper aims to answer the following question: how could we implement the principle "equality between present and future generations"? Taking into account the data provided by the National Institute of Statistics from Romania, Eurostat, the World Bank and EU regarding: developments in the birth rate, the number of contributors, life expectancy, the forecasts made in Romania, but also internationally, on sustainability and reasonability of public pension systems, are pessimistic. This paper proposes a solution as simple as it is effective. Why could it not exist in Romania a decent unique minimum pension linked to a decent minimum wage through the mandatory pension contribution rates? Why the welfare of pensioners in 2065 must depend on the existing number of employees in 2065, particularly given the pessimistic demographic forecasts that indicate a population decrease of 20% since 2060? The current PAYG pension system it will not be sustainable in future. Therefore it has to be changed.*

**Keywords:** pensions, reformation, public pension system, social insurance

**Clasificare JEL :** E60, H55, I38

### **1. Introduction**

Retirement is an important event for everyone, as good as marriage, divorce, raising a family, or even death, and therefore it is not something to be neglect. Psychologists and mass media frequently debate about the crisis before retirement.

Being an important event and simultaneously having an important economic and social impact in worldwide, the retirement has different rules and provisions of pensions in every country.

There are some questions whose answers are very important, such as: which is the decent retirement age?, which is the decent amount of pension?, what system is better for a country amongst public or private?, which is the ideal minimum stage of contribution for public system?

There are huge and growing deficits of the pension systems caused mainly by ageing, population reduction and financial crisis. This is the case in almost all EU and other countries worldwide.

Therefore the main problem of any public pension system is the long term risks of unsustainability. In order to try being sustainable a pension system has to rely on entirely private system or on pillar system of pension schemes, during a long properly period of time. The pensioner's major problem is the inequity of the pension size or amount after a long period of contribution.

Countries from all over the world are trying to continuously extend the age of pensioning, accordingly with the increasing of the average lifetime. For example, in Australia the retirement age will be increased to 70 years old after 2035. Moreover, the countries are trying to avoid collapse by deep reform. For example, Romania has introduced in 2007 the three pillar system of pension schemes, upon a tested and recommended model of the World Bank [1] – [8].

### **2. Representative pension types**

Briefly we will present some types of pension system from three representative countries with high living standards: UK, US and Denmark.

In UK there are many types of pension system, such as: state pension („the basic state pension”), additional state pension or „the new state pension” (after 6 April 2016), early retirement, pension credit (to complete the revenue till the minimum income), occupational pension, over 80 pension, stakeholder pension [9].

The minimum income in UK for all people above 60 years old is approximately 600 £ per month (137.35 £ per week) and for the pensioners who live with a partner is 209.70 £ per week (approximately 900 £ per month).

The pension age after 2020 is 65 and it will be gradually increased to 68 since 2024 till 2046. The working life is 49 years starting with 2020. All the information about state pension age, pension credit calculator, the new state

pension and others can be obtained online [9].

The basic state pension in UK is now maximum £115.95 per week [9], and yearly it will slowly increase.

In US, the land of all possibilities, there are a lot of types of retirement plans, such as: Individual Retirement Arrangements (IRAs), Roth IRAs, 401(k) Plans, 403(b) Plans, SIMPLE IRA Plans (Savings Incentive Match Plans for Employees), SEP Plans (Simplified Employee Pension), SARSEP Plans (Salary Reduction Simplified Employee Pension), Payroll Deduction IRAs, Profit-Sharing Plans, Defined Benefit Plans, Money Purchase Plans, Employee Stock Ownership Plans (ESOPs), Governmental Plans, 457 Plans, 409A Nonqualified Deferred Compensation Plans [10]. Actually, the motto in this country is “start saving, keep saving and stick to your goals”.

In Denmark the pension system is very well-established, over 95% of Danish are paying into private pension schemes. There are different types of pension schemes in Denmark, such as: state pension scheme, statutory pension schemes (ATP contribution and SP contribution), collective pensions, company pensions or private pension schemes [11].

As a conclusion, the pension size is determined by the period of contribution and the private systems ensure an important supplement for state pension.

### 3. Romanian Pension System

In Romania the pension system has been gradually reformed and since 2007 it include a public system with two pillar of pension schemes and a private system (the third pillar), upon a tested and recommended model of the World Bank [1]-[8]. Currently, the Romanian public pension system is a „pay as you go” system and it is based on solidarity between generations [12].

The lifetime expectation in Romania is increasing, and the evolution in long term of the number of pensioners, monthly average pension, the dependency rate of the public system and the replacement rate of earnings through pension are very risky for the sustainability of the pension system [13].

Yearly evolution of total average number of all social insurance pensioners between 2003-2015 is showed in fig. no. 1, (social insurance include: state social insurance, social insurance from former farmers system, social insurance from Ministry of Culture, social insurance from Insurance House of Lawyers, social benefits– pension type and war, invalids, orphans and widows pensioners) [15].

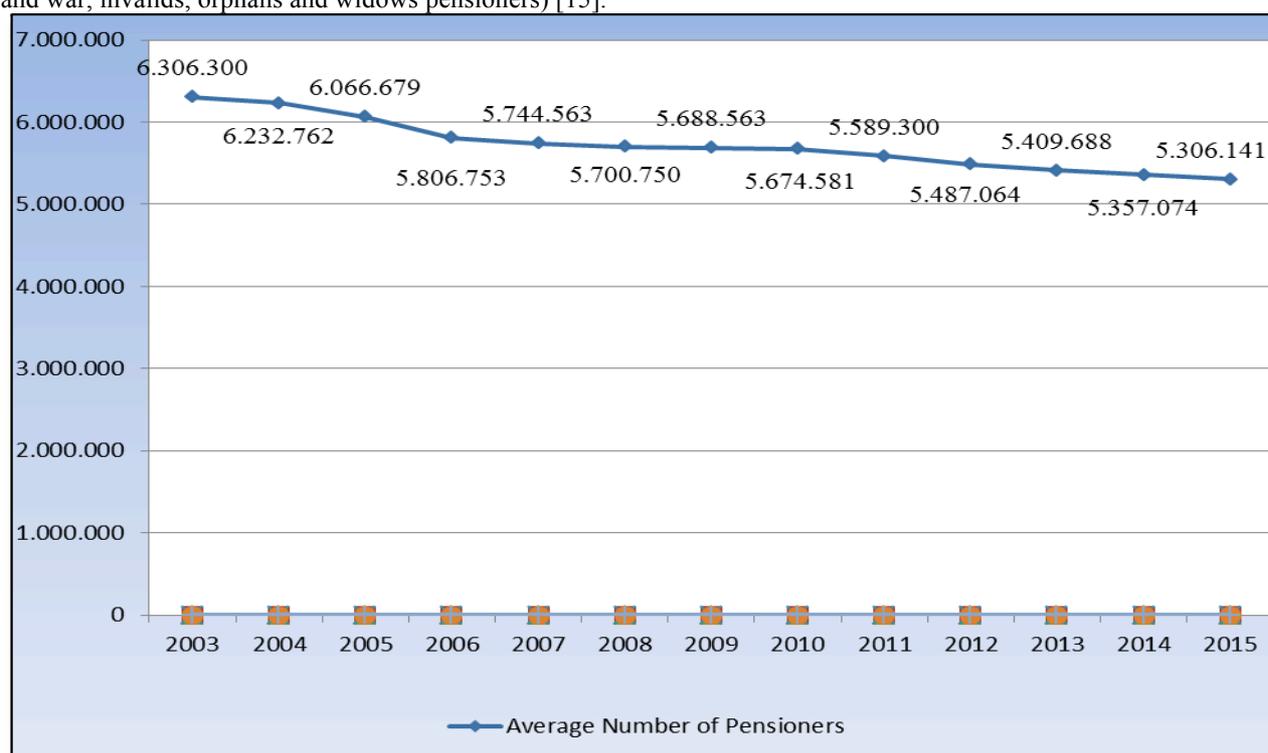


Fig. no. 1: Yearly evolution of average number of pensioners between 2003-2015 (Source: National Institute of Statistics – Average number of pensioners and monthly average pension, year 2015 - [http://www.insse.ro/cms/sites/default/files/field/publicatii/numarul\\_de\\_pensionari\\_si\\_pensia\\_medie\\_lunara\\_in\\_anul\\_2015\\_0.pdf](http://www.insse.ro/cms/sites/default/files/field/publicatii/numarul_de_pensionari_si_pensia_medie_lunara_in_anul_2015_0.pdf), pag. 33-34)

We see that the average number of pensioners is decreasing yearly, from 6.3 million to 5.3 million, with 1 million pensioners less than twelve years ago.

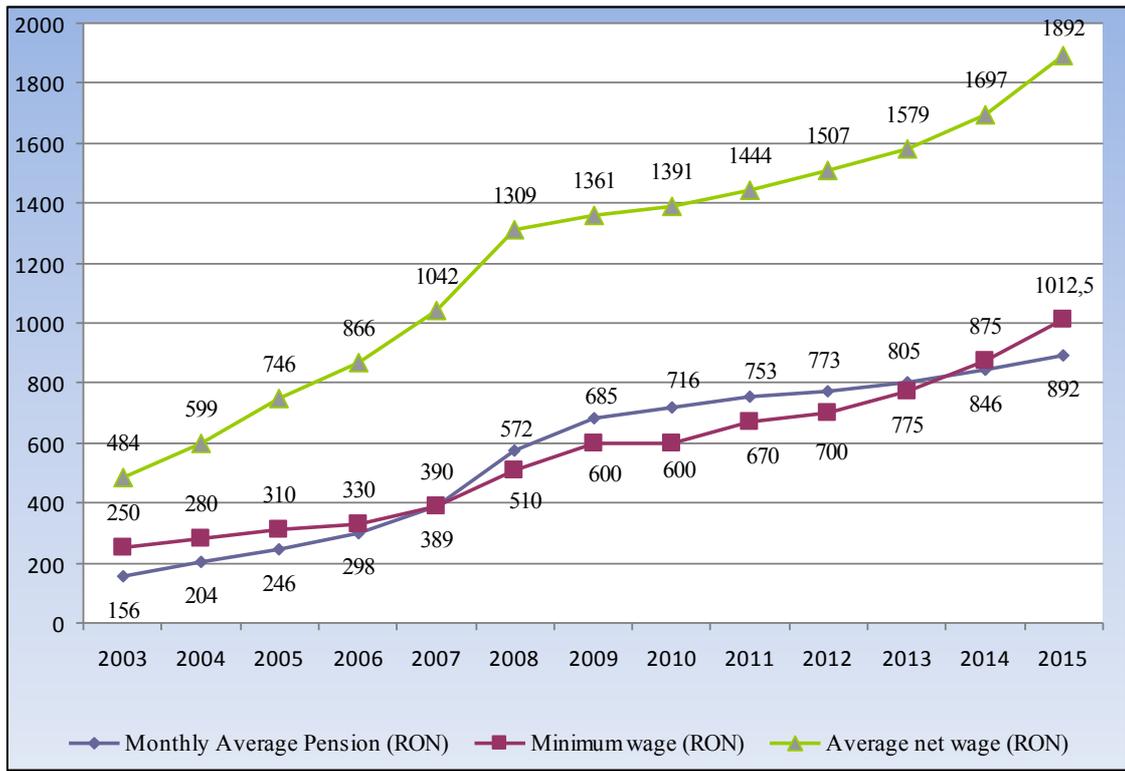


Fig. no. 2: Yearly evolution of monthly average pension, minimum wage and average net wage, between 2003-2015 (Source: National Institute of Statistics)

We see that all three indicators are rising throughout the period analyzed and the minimum wage is higher than the monthly average pension only between 2003-2007 and 2014-2015.

Moreover, the share of state social insurance pensioners by levels of pension at December 2015 is reflected in fig no 3.

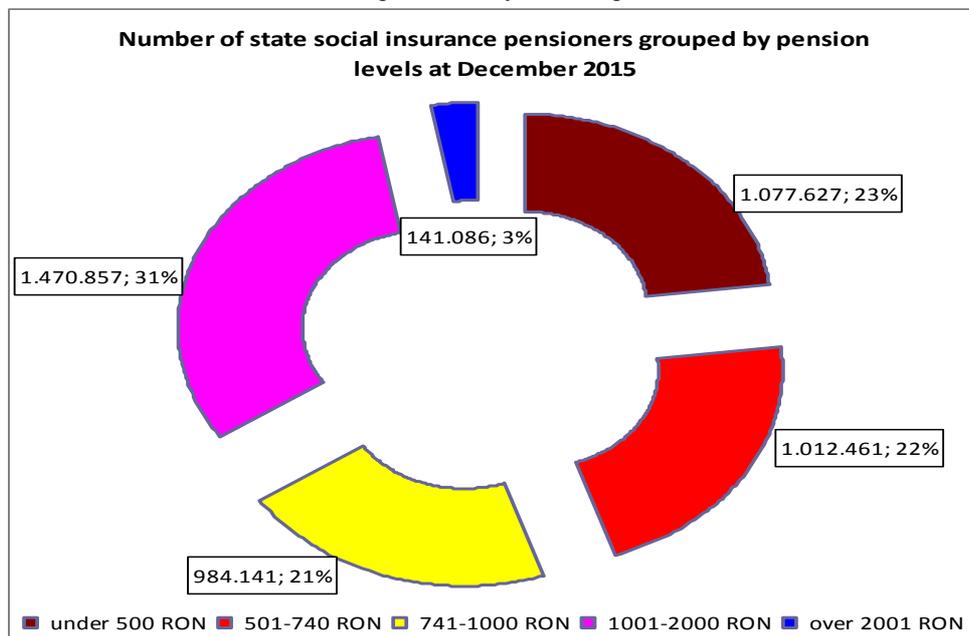


Fig. no. 3 Number of state social insurance pensioners grouped by pension levels at December 2015 (Source: National Institute of Statistics – Average number of pensioners and monthly average pension, year 2015)

We see that over two-thirds of all state social insurance pensioners received at the end of 2015 pensions under 1000 RON and only 3% received pensions over 2001 RON.

“If in 1990 more than three employees sustained a pensioner, the relationship between employees and pensioners has reached in 2009 a nearly one (0.98 employees / 1 retired). If current conditions for retirement persist in 2050 half of Romania's active population will be retired. After 2030, the pension system will collapse because of low labor input together with massive inflows of pensioners, which will contribute to the degradation rate of dependence”

[12]. In 2015, in Romania the ratio between average number of state social insurance pensioners and average number of employees was 10 to 10, and between average number of all pensioners and average number of employees was 11,33 to 10 (0,88 employees / 1 retired) [15].

According to The World Bank estimations, the public pension system deficits are to evolve [14, pag. 13-15].

For Romania the next reform is to change the third pillar (private optional pension system) from DC (defined contributions) to DB (defined benefits) [13].

#### 4. Proposal regarding the reformation of the Romanian public pension system

Public systems of all states have been more affected by crisis than private schemes [12]. So, Romania should also stimulate private savings (third pillar) and there is needed some legal improvements and an increasing contributions for the second pillar [13, pag. 9].

Every state should focus on stimulating and well advertising the private pension systems.

Romania needs to focus more on moving the responsibility of supporting the pensions to private area. The state will no longer be able to bear all that pressure in the future.

Considering all the above, we believe that the following proposal is as simple as it is effective, while being assured the implementation of "equality of rights between present and future generations": after application of mandatory contributions for pension to the minimum wage for minimum 40 years, a pensioner will receive a decent pension (homologous with minimum wage). Simply put as: decent minimum wage – decent minimum state pension. Of course, further calculations are required to establish a decent wage, with gradual changes over time, thus ensuring a correlation with decent minimum pension.

Therefore, legal contribution quotas supported by employees could be applied only to individual income level equal to decent minimum wage and the legal contribution quotas supported by employers to gross wage. In this way, the employers would bear the same pressure, instead employees with higher incomes than minimum wage could use even the remaining difference, obtained by applying legal contribution quota only to the minimum wage, to contribute more for private pensions. In that way, Romanian pensioners would receive an equal minimum pension from state.

On the other hand, Romania must efficiently stimulate, like US, individual contributions for private pensions, accompanied by a good advertising amongst population regarding this modern form of provision. Everybody should know their retirement needs and take charge of their future and plan ahead. Romania has to move the responsibility towards each individual person in matter of retirement.

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