



ASPECTS RELATED TO THE BALANCE OF THE PUBLIC PENSION FUND IN ROMANIA

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Abstract

The issue of pensions and social security system is particularly important in Romania and in the European Union. The incoherent politics conducted over time by the governing political parties made the balance of the pension funds that cover an important category of the population – the elderly, even more fragile. A series of factors not necessarily related to social policies conducted by countries have a strong impact on the sustainability of the pension system. We hereby refer to the demographic factors, the dependency ratio, the unemployment rate and the average guaranteed net salaries. Among the incoherent policies conducted by the state we mention the change of the retirement age, the disrespect of the principle of contribution and the existence of special pensions, the faulty indexing of pensions, the fight against tax evasion in the field. The result is an imbalanced pension fund and the need to cover the pension fund by other taxes and duties. This imbalance cannot exist on long term, the credibility of the system being put in danger. Thus, there would be appropriate to take emergency measures including encouraging the development of voluntary pension system, the flexibility of the labour market and not at last a demographic policy focused on increasing the birth-rate.

Keyword: public pensions, state social security, pension fund, dependency ratio

JEL Classification: H55, H62

I. Introduction

The approach of the issue of pensions in the European Union is treated very carefully, recommending the observance of basic rules by member countries.

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A first rule refers to the fact that the pension system must provide to its beneficiaries an adequate and secure income. A second rule is that the pension system should not affect fiscal stability or create an excessive burden on future generations.

Another rule is that the pension contributions system should not affect the labour market.

An important rule is that the pension system should inspire confidence in citizens' long-term future, confidence that is partially disturbed by doubts related to the system's ability to cope with the demands of those who will retire.

Given that the pensions of the current pensioners are paid of the contributions of the current employees, it is very difficult to maintain a financial balance in a fragile situation where the number of beneficiaries is so high, and the number of taxpayers is so low.

This study addresses the financing difficulties of the pension system in Romania and the difficulties of the public pension system in reaching a balance between collections and payments given the above described situation.

As methodology we have used the analysis of data from several public institutions with attributions in this area.

II. Data

At the end of 1989, Romania had eight million employees and 3.6 million pensioners. The dependency ratio (the ratio between the number of employees contributing to the state social security fund and the number of beneficiaries) was 3.4 employees per one pensioner, the pension fund having a surplus of 500 million USD.

From 1990 to present the sustainability of the social security system has been continuously eroded under the impact of rising unemployment ratio, the average number of pensioners and the substantial decrease in the average number of employees or contributors to the pension fund.

The only years when the pension fund had a positive final result were 2003, 2004 and 2006 and now the situation is specific to a deep crisis. At least theoretically, the pension payments out of loans or the general consolidated budget is unsustainable on medium and long term.

So since 2006 the social security budget is financed mainly by the state budget, this situation being not only the effect of the economic and financial crisis, but largely the result of inconsistent and unsubstantiated social policies applied by all governments that succeeded during the last twenty-five years, policies that have determined a strong financial burden on the pension system.



The biggest abnormality of the Romanian economy is that at a population of about 20 million people there are about 10 million people of working age, of which only 4.6 million are employed, and 5.1 million are retired.

Currently the dependency ratio is 1.15, decreasing, but not enough to make a solid and balanced social security system. Many factors have a great impact on the erosion of the system's soundness and on the mistrust in it.

So, every employee in Romania supports, by the social contributions he/she pays, the pensions for about 1.15 pensioners, better compared to 2010, when the ratio was 1 employee for 1.26 pensioners, but much worse compared to 1990 .

Romania has now reached the lowest number of pensioners since 1995, 5.3 million, but the decrease of this population category does not improve the overall distortion of the system, because the number of pensioners is still greater than that of employees. Here's the evolution of the number of employees and pensioners:

Table 1. Evolution of the number of pensioners and employees

YEAR	MONTHLY AVERAGE PENSION (ron)	NUMBER OF PENSIONERS (thousand pers.)	NUMBER OF EMPLOYEES (thousand pers.)
2001	131	6.192,4	4.470,3
2002	163	6.212,3	4.331,0
2003	187	6.141,5	4.333,8
2004	232	6.069,8	4.398,3
2005	267	5.902,3	4.501,2
2006	311	5.638,5	4.575,0
2007	399	5.575,4	4.717,2
2008	593	5.531,8	4.738,6
2009	711	5.518,5	4.367,7
2010	739	5.504,8	4.101,6
2011	773	5.421,9	4.172,1
2012	778	5.321,3	4.311,6
2013	809	5.246,3	4.328,0



2014	845	5.196,1	4.423,3
2015	886	5.280,2	4.577,4*

Source: National Institute of Statistics.

*data as of 30.09.2015

The types of pensions paid and the monthly average pension are as follows:

Table 2. The situation of pensioners as of 30.09.2015

TYPE OF PENSION	NUMBER OF PENSIONERS (THOUSAND OF PENSIONS)		% TOTAL PENSIONERS		AVERAGE PENSION (LEI)	
	3 rd quarter 2014	3 rd quarter 2015	3 rd quarter 2014	3 rd quarter 2015	3 rd quarter 2014	3 rd quarter 2015
Normal retirement age	3.915	3.914	73,2	74,0	960	1.011
Invalidity	709	675	13,3	12,8	574	581
Survivor's pension	606	592	11,3	11,2	469	501
Partially early retirement	95	84	1,8	1,6	624	626
Early retirement	20	23	0,4	0,4	1.040	1.073
TOTAL	5.345	5.280				

The deterioration of the dependency ratio is reflected in the evolution of social security contributions. In the early '90s the contribution represented 20% of the gross salary, but in the attempt to obtain new resources for a pension system nearly collapsing, the percentage of the contribution increased by 15 percentage points until 2002.



The increase of the state social security contribution was not sufficient to reach certain revenues in order to maintain real pensions at the level of those in October 1990.

Since 2003 the evolution of the social security contribution rates has had a downward trend, although it was far from achieving financial balance.

This trend has been driven by policies of no longer burdening the economy, these contributions, whether paid by the employee or by the employer, significantly raising the cost of labour, making Romania less attractive for investments, encouraging also the increase of tax evasion.

Here is how evolved the social security contributions rates lately:

Table 3. Evolution of the social security rates

Period	CONTRIBUTION RATE (%)						
	Insured person	EMPLOYER			TOTAL		
		Normal conditions	Particular conditions	Special conditions	Normal conditions	Particular conditions	Special conditions
2001-2002	11,67	23,33	28,33	33,33	35,00	40,00	45,00
2003	9,50	24,55	29,50	34,50	34,00	39,00	44,00
2004-2005	9,50	22,00	27,00	32,00	31,05	36,50	41,50
2006	9,50	19,75	24,75	29,75	29,25	34,25	39,25
2007	9,50	19,50	24,50	29,50	29,00	34,00	39,00
2008	9,50	18,00	23,00	28,00	27,50	32,50	37,50
2009-2014	10,50	20,80	25,80	30,80	31,30	36,30	41,30
2014-present	10,50	15,80	20,50	25,80	26,30	31,30	36,30

The decrease of the social security contribution by five percentage points since 1 October 2014 leads the cumulated payroll tax rate for social security budget from 31.3% to 26.3%. In a first assessment, the coverage rate of the pension expenditure from the payroll tax would decrease from about 73% to 61%. This measure has a positive effect on reducing labour costs but does not solve the problem of the balance of the pension fund.

The real value of pensions has decreased over time and it records an oscillating trend depending on economic performances and on the political measures at a given time. Thus it seeks to achieve as agreed objective the maintenance of a replacement rate of insured income at least at 45%.



The process is explicable because pension indexation mainly followed inflation rate, while salaries rose faster, following the market logic with other variables such as productivity, labour mobility and economic growth.

III. Causes

The financial situation of the pension scheme has been problematic even since 1990. Although total pension expenditures in Romania represent a smaller share of the GDP (about 8.8%) compared to the EU average (10.4%), they are still too high compared to budget revenues. The pension fund has had deficits since the early '90s.

The demographic development is not favourable for a natural balance of the pension system in the future, demographic projections being a serious cause of concern. The UNO estimates show that until 2030 the "65+" age group will represent almost one fifth (18,9%) of the Romania's population, compared with 10.4% in 1990 and 14.8% in 2005. Here is the demographic profile of Romania during the period 2000-2015:

Total population (millions)		Annual rate of the population growth (%)		Urban population (% of total)	Population under the age of 5 (mil)	Population of 15-64 years old (mil)	Population of 65 years old and over (mil)	Fertility rate (number of births per woman)		Average age
2014	2030	2000 - 2005	2010 - 2015	2014	2014	2014	2014	2000 - 2005	2005 - 2015	2015
21,6	20,2	-0,2	-0,3	52,9	1,1	15,1	3,3	1,3	1,4	40,0

In the perspective, the issue of the age dependency ratio will increase, thus affecting social security systems which will result in continued reform of social security systems.

For a long time, the standard retirement age has remained low. The essential causes of standard retirement age reduction is the work of the working groups, the retirement on grounds of disability and the early fulfilment of the full contribution period. In addition there are lower retirement ages considered by special pension schemes such as 50 years old for civil aviation staff, 55 years old for military and police staff, 60 years old for magistrates and auxiliary personnel in courts and courts of appeal.

In recent years, the public pension system has been facing a very serious problem, namely that related to the massive increase, often fraudulent, of the retirements on grounds of disability. Thus, from 600.000 people that received disability benefits in 2001,



there are 900.000 disability pensioners in 2009, thus registering a growth having significant adverse effects on the social security budget expenditure.

The existence of special public pension systems, that have introduced a range of privileges and unequal treatment for certain professionals, has created a huge gap between the smallest and highest public pension. In September 2015, the highest pension was amounted to 27.453 lei and the net average pension was amounted to 886 lei, so the highest pension is 31 higher than the net average pension and 68.6 times higher than the net minimum pension amounted to 400 lei as provided by the law.

IV. Effects

The lack of correlation between the increase of revenues and expenditure from the pension budget has determined the deficit to grow every year. Since 2010 the deficit has been consistently to over a quarter of the total state pension expenditure for about five million pensioners. If in 2008 the social security budget deficit was amounted to 1.4 billion lei, it reached a record in 2011 of 13.15 billion lei. In 2012 and 2013 the deficit recorded certain corrections but in 2014 it exceeded the threshold of 13 billion lei, and the estimated trend for the coming years is to maintain it at 11.7 - 13.3 billion lei. According to an estimate of the World Bank in 2009, it is highlighted the fact that in 2050 the deficit created by the pension expenditure paid from the GDP, by maintaining the current system, will reach 12%.

The excessive increase of the budget social security expenditures (+ 70.5% in 2009 compared to 2007) took place in the context of a favourable dynamics of collections of contributions in the period before the financial crisis as a result of the economic boom, and also anticipating the maintenance of this trend in the future. This trend has not been maintained.

In addition, when most of the children born in the explosion of births determined by *Ceausescu's* decree in 1966 will reach their retirement age, the generation, significantly less numerous, of children born after 1990 will form the majority of the taxpayers for the former ones.

The problem of the structural deficit of the public pension system has not been solved. Thus, the budget expenditure for pensions are unsustainable in relation to the contributions collected on medium and long term.

It became obvious the need to find an indexing rule in order to ensure long-term sustainability of the social security budget instead of the discretionary approach in the past.

Basically the pension increase is not transparent and explanatory and not just from social contributions as it would be correct according to the principle of contribution.



There are important risks related to the sustainability of the social security budget and the appropriateness of any increases or additional increases of expenditure or cuts of contributions should be considered only in the context of identifying alternative solutions to reduce deficit, in particular by broadening the tax base.

V. Conclusion

For balancing the pension fund, increasing the confidence in the system and generating decent income for pensioners, urgent measures are required. There are limited and unpopular solutions such as: application of higher contributions rates to taxpayers (increased of tax burden), decrease of the real value of pensions or supplementation of the pension fund with grants from the state budget.

However this would only partly solve the existing problems on short term. In the public pension system the following measures are necessary:

- Strict adherence to the principle of contribution, eliminating special pensions;
- Establishment of rules and conventions enabling the extension of the working life beyond the age of 65, with fiscal and social benefits for both the elderly and employers;
- Elimination of the obligation to retire at the legal retirement age, especially in the public system;
- Abolition of early retirement and partly early retirement or stipulation of more severe penalties in calculating pensions in the early retirement schemes;
- Cessation of payments to 2nd pension pillar for a period of 5-10 years;
- Motivation and encouragement of employers and employees to participate in the 3rd pension pillar, with the advantage of fiscal benefits;
- Effective measures to fight against undeclared work, increase of the number of legally employees by active policies in the employment area;
- Initiation of concrete measures to fight against work with payment of the minimum guaranteed salary, or under partial employment agreements;
- Increase of the number of taxpayers by attracting those working in agriculture or as free entrepreneurs and who are currently uninsured, as well as other categories of persons who receive income;
- Improvement of fiscal discipline.



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