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The public pension system in Romania – analysis before and after 1999

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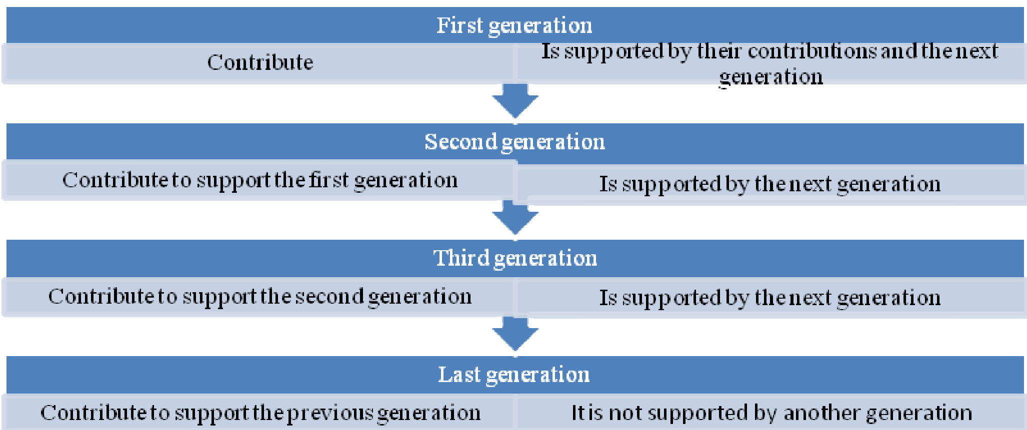
Abstract: Objectives This paper aims to examine the public pension system in Romania and the significant differences that 1999 brought it. It is important to see if system effects such as the number of beneficiaries and collapse on the number of taxpayers are experienced in present. It explores the main types of pension granted in the public pension system - pensions for old age. **Approach** It is an attempt to identify the main sources (contributions owed by employers and employees) and also the way pensions are calculated and given before and after 1999. **Results** We conclude that public pension system in Romania has suffered many changes in a positive way. **Implications** For taxpayers, both employers and employees it is important that the public pension system work in optimal conditions, that the minimum and maximum contribution "stage" take the proper values. **Value** Knowing the importance of the public pension system in the Romanian society will know what measures should be taken to improve it.

Keywords: public pension system; social security contributions; contribution stage

Known as the first pillar of the pension system, the public system operates as a pay-as-you-go (PAYG) - paid gradually as the situation arises. It is based on the notion of social solidarity and it manages in a distributive manner an insured component of contributions and beneficiaries (Figure 1).

Figure 1 PAYG pyramid type system



Formally, the PAYG system can be defined by the following relationship (Constantinescu D., Constantinescu M., *Private pension funds –First part*, Editura Bren, 2005, pg. 25):

$R_c S_{nm} N_a = P_{nm} N_p$, where : R_c – *contribution rate to the PAYG system;*

S_{nm} – *Average nominal wage;*

N_a – *number of employees;*

P_{nm} – *average nominal pension;*

N_p – *Number of Pensioners.*

The public pension system in Romania inherited from the Ceausescu regime was a poor collection of separate systems mainly in: workforce in the industry, farmers, artisans and craftsmen, church officials and other categories. The main types of pensions (those of former workers in industry) were financed by social insurance contributions, so that in 1989, the taxpayer-beneficiary ratio was 3.5. Balance seemed that can support a PAYG system, but there were two major deficiencies that makes this slant negative: the formula was too generous and pensions were granted to those who did not contributed.

The rules governing the pension system at that time (many of them adopted in 1977), made the pension system to be non viable, so pensioners were entitled to a pension equal to 75% of average earning of the five best years from the contribution of the last ten. Social contribution at that time was 14%, but with a retirement rate of 65% or higher, and a 3.5% rate payers-beneficiary, social contributions should arrive at 18.6% to tilt the balance positive. Another problem was that the existence of an additional pension scheme, which has functioned since 1968: because contributions to the basic scheme of the pension system were paid entirely by employers, contributions to the additional scheme were paid by the employees, which gave workers the right to a supplementary pension for 8% of the average formed from the best five years of contribution in the last ten of work. This has led to the retirement rate increase by 16%.

Also in the same period (1990s), the state granted pensions to a large number of pensioners who did not contributed. A broad category of beneficiaries were considered farmers, whose contribution after the dissolution of cooperatives in 1990, became optional. In 1990, less than 5% of potential contributors have agreed to become taxpayers and thus in order to cover pension to farmers the state introduced a special tax for companies that produce and sell agricultural products.

Although, 1992 is emerging from more than achieving a unified national system of public insurance through the state social security integration in other systems (social security for farmers, the handicraft cooperatives, the Romanian Orthodox Church, the artists, of musicians, composers and writers) effects of the system inherited from the Ceausescu regime was very strongly felt: a growing number of beneficiaries (governments of 1990-1996, in order to strengthen support from the population, tend to provide free benefits and special interest groups to provide special provisions for early retirement), collapse the number of taxpayers (which was due to significant increases in unemployment - by the end of 1998, the unemployed constituted 10% of active persons) and lower active headcount by 25%.

The next ten years in Romania have demonstrated the need for major reform of the pension system to eliminate the effects inherited from the communist regime and to increase revenues and social security. Thus, the Minister of Labour and Social Security at that time, began work on a measure designed to correct imbalances in this system. The first legal regulations and proposals for a comprehensive reform of the public system (first pillar) have emerged in 1999. The new law, passed in March 2000 and published in the Official Gazette no. 140 of April 1, 2000 reflects substantive changes. The law puts a stop to unhealthy practices of the pre-reform system and other moderate tightening. One of the improvements in financial sustainability represents, on one hand additional revenue and reduced expenditure on the other hand. Additional revenues will be greatly increased by the fact that two million self-employed (those who are required to self-declare their income and to make social security contributions at a standard rate of 35%), including farmers are forced to adhere to the basic system and reported revenues of these categories cannot be less than 25% of average salary. Another surplus on the revenue side is the new point system (modeled on the German system), which replaces the old formulas and its excesses (the beneficiary is entitled to a pension equal to 75% of average earnings in the 5 best years contribution in the last 10). Thus, workers accumulate points for each full year worked in relation to average wage. At retirement, the point value is determined in accordance with a formula to ensure that such a worker would receive a pension equal to 45% of gross salary in retirement (Law no. 19 of 17 March 2000 on the public pension system and other social insurance rights).

The calculation formula in accordance with Articles 76, 77 and 78 (1) of Law no. 19/2000 determines: „the amount of retirement pension to the date of entry is determined by multiplying the annual average score achieved by the insured during the period of contribution to a pension point value in the month of retirement. Annual average score, performed by the insured during the period of contribution is determined by dividing the number of points resulting from the summation of scores made by the insured annual during subscription period to the number of corresponding years to a complete contribution stage. Insured's annual score is determined by dividing by 12 the score resulted in that year from summing the number of points each month. Number of points achieved in each month are calculated by dividing individual monthly gross wage, including bonuses and supplements or, where appropriate, the monthly insured income, which formed the basis for individual social security contribution, the average gross monthly salary, comunicated by the National Commission for Statistics”.

Spending will be reduced by gradually increasing the statutory retirement age (62 for men and 57 for women is increased in small steps over 13 years to 65 for men and 60 women) and better regulate the conditions under which a worker early retirement is entitled to a full pension. The new law limits the right of workers in normal working conditions, and those in „special difficulty” category to retire early with full pension. The new law eliminates the additional pension contributions, which should reduce expenses and, therefore, the number of retirements and also the expenses supported by the social security budget.

Other significant differences are that the new law requires: reclassification of jobs (to reduce the proportion of workers from „special difficulty” category), provisions for more stringent disability benefits (recipients of disability pensions, but who can take care of them itself are examined every 6 or 12 months), creating a public body, independent to collect contributions and distribute pension (National Social Insurance House).

While the new law adopted in 2000 has brought major changes in practice, over the last 20 years we have witnessed a sharp deterioration of the report contributors-beneficiaries, so that today, a Romanian employee contributes monthly to a social insurance system for 1,3 retirees, compared to 1989, when 3.5 taxpayers contributed for one pensioner (Table 1).

Table 1 Dynamic dependency ratio between the average number of pensioners and average number of employees
-thousands of persons-

Year	Average number of pensioners, including farmers	Average number of employees	Dependence report%
2001	6.192,4	4.502,3	1,37
2002	6.212,3	4.372,8	1,42
2003	6.141,5	4.384,8	1,40
2004	6.069,8	4.420,9	1,37
2005	5.902,3	4.536,5	1,30
2006	5.638,5	4.594,3	1,23
2007	5.575,4	4.720,1	1,18
2008	5.531,8	4.806,1	1,15
2009	5.518,5	4.594,6	1,20
2010	5.504,8	4.238,6	1,30

Source: National Statistic Institute, www.insse.ro

Also, improvements on the new legislation brought, did not increase the average social security pension, as, at the end of 2010, representing almost a third of average earnings growth, 739 lei, which, in any case, can not provide decent living for a pensioner.

Further, it is interesting to note that elements such as: tightening the conditions for early retirement pension, formula restriction and increase retirement age to the new law led to an increase in revenue in the state social insurance budget. From Table 2, we can see that total revenues increased during 2000-2010. However, these revenues were not sufficient to cover project expenditures and thus the state social insurance budget has received subsidies to cover the deficit. One can see that the years 2006-2007 have been only the social security budget has not received grants from the state budget and years which saw the largest budget surplus.

Table 2 Execution of the state social insurance budget

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Revenues	5101,6	7623,3	9724,5	12403,8	16167,1	17624,3	20277,3	24632,0	32832,6	39431,3	42871,9
Grants	114,9	286,2	252,8	689,8	1760,3	10,9			1379,6	6397,5	10954,7
Expenditures	5562,7	8343,8	10720,3	12377,6	16166,5	17744,9	18494,3	23093,7	33704,6	40389,9	42639,3
Deficit (-)/Surplus (+)	-461,1	-720,5	-995,8	26,2	0,6	-120,6	1783,0	1538,3	-872,0	-958,6	232,5

Source: National Statistic Institute; Ministry of Public Finance

Conclusions

The system is based on the Pay-as-you-go (PAYG). In other words, active generation supports through its social contributions, pensions for inactive generation. In fact, from the information here presented is clear that funds were insufficient to ensure adequate retirement.

Twenty years after the fall of the communist regime and more than ten years after the adoption of the first pillar pension law in Romania, requirements for creating a modern social insurance system, able to provide reasonable pensions, remain a necessity.

As we noted, even if the number of beneficiaries has been reduced and the number of taxpayers increased by 2008 (later recorded to reduce them), social insurance budget deficits remain substantial.

With these modifications, the first pillar of the pension system wanted to create a coherent framework for the implementation of legislation in the field, saving human and material resources and also strengthening the control on creation and use of resources. However, public social insurance system in Romania is in continuous development and improvement.

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