

Pension System in Romania – The Fundament of Social Insurance

Amalia Elena Ioniță

Universitatea Petrol-Gaze din Ploiești, Bd. București 39, Ploiești
e-mail: ionita_amalia@yahoo.com

Abstract

Reforming the pension system in Romania starts from the present problems to which it is confronted. After 1990 important changes took place in order to integrate certain social categories into the area of social insurance. The article below presents some of the consequences of the legislative development as well as aspects that reflect the impact of the economic situation of Romania among retired persons and their revenues.

Key words: *pension point, public pension scheme of PAYG type, private pensions*

Conceptually, the pension system is not only an element of social protection and politics but also a component of market economic system. This system is made up as a budget system comprising of incomes and expenses. Incomes come from obligatory contributions of the population represented by employers and employees and expenses represent transferring this contribution to the beneficiaries: the retired persons.

The value of the pension is constrictive. Initially (during the period 1990-2000), the pension value was calculated not only according to the period but also according to the medium income registered in the most “valuable” five work years from the last ten. However this system produced a series of inequities among which we mention the consequences of anticipated retirement.

Permissive legislation practiced in the 90’s allowed anticipated retirement to the persons approaching retirement age. In this way the state tried to “balance” unemployment expenses transforming potentially unemployed persons into retired persons/pensioners.

This measure was taken to the prejudice of the relation between the number of tax payers and those number of pensioners, to a lower rate of replacing salaries by pensions which do not cover the necessities of a decent living in their majority. All these took to a crisis of pension financing. The necessity of a reform appeared.

Thus in March 2000 a new law concerning pensions was adopted (law no 19/17 March 2000 regarding the public system of pensions and other social insurance rights). This law tries to correlate the level of the contribution and that of social insurance; it is also an attempt to re-correlate pensions by payment in order to eliminate distortions appeared in the period 1989-2000.

In this new formula, contribution level depends on work conditions. The law stipulates that a third from the contribution should be supported by the insured, two thirds by the employee, while the payment of both contributions should be done by the state. Salary and contribution payment should be done simultaneously under bank control.

According to the aforementioned law there are four categories of obligatorily¹ insured persons: those employed with an individual work contract; persons that detain elective, executive, legislative or judiciary functions during their and the members of handicraft cooperation; people working on their own, agriculturists, priests under religious service recognized by the state and others. For unemployed persons (persons who benefit from unemployment indemnity), contributions are undertaken by the unemployment fund. Contributions are non-taxable.

There are other persons that can be included in the public system of pensions according to a contract of social insurance. The following categories are excluded from the public system of pensions: military, magistrates, lawyers and, from 2003, diplomatic and consular staff.

The calculation of individual contribution to social insurance starts from the salary (including primes and bonuses), plus insured monthly incomes, that cannot be smaller than a quarter from the medium salary.

The calculation of the contribution level is established each year by the Law concerning the social insurance budget.

The law brings modifications as the standard retirement age and the minimum payment period are concerned. The limit for receiving a complete pension is 60 years for women and 65 for men. This age limit is supposed to grow progressively until 2013. The periods of minimum and complete contribution were raised up to five years. This is expected to grow progressively simultaneously with the age limit.

Certain specifications and eligibility criteria were changed once the new law was introduced.

The criterion of calculating the amount of the pension represents the basic axis of the new law and the innovative element brought to the system of national social insurance. The level of pensions is calculated starting from an average annual score realized by the insured during his contributive period, multiplied by a percentage of the medium salary.

The annual average number of points is calculated by summing the number of points gathered during the work period and sharing this number to the number of months in which the person paid taxes to the social insurance fund. The annual number of points is calculated as the average of the monthly points, established by sharing the monthly medium income to the monthly medium salary, according to the National Institute of Statistics and Economic Studies.

The maximum value of the average annual points cannot surpass 5 points, starting from 2003. The minimum value of a pension point is of at least 45 % from the medium salary for the year. It is approved according to the law concerning social insurance budget. Thus the pension is indexed at the same time with the medium salary.

For the year 2006 the value of the pension point is of 323, 1 lei², therefore the pension value will be of 1615, 5 RON.

Adopting the Law of the public system of pensions represented undoubtedly a step forward in the reglementation of the system: it introduced order, by taking all revenues into account; it linked pension calculation to the entire period of work, not only to the best 5 years of the last

¹ ***, Law no 19/17.03.2000 – published in the *Official Gazette*, part. I no. 140 from 01/04/2000 regarding the public system of pensions and other social insurance rights, with all further modifications

² ***, Law no 380/2005, published in the Romanian Government Ordinance no. 1150/19 2005 / Law of social insurance budget on 2006

10; it opened the way to the private system of pensions; it stimulates a longer period in the work field; it stimulates employment.

But the law has its own minuses: the retired persons receive redistributed incomes (because of the PAYG scheme). They do not receive their own economies and the indexation of the point system is limited to 5 points even if the person surpasses these points; in this case the importance of points calculation is essential.

The Emergency Ordinance no 49/2001 emitted as an amendment to Law no 19/2000 introduced new inequities between pensions especially in the case of the persons with a period of 0-50 years of work and who come from highly specialized fields.

Another inequality is the disadvantaged persons retired before April 1st 2001³.

At present the law regarding private pension system is under project in order to secure a satisfactory income after retirement. Each participant to tax payment will have their own count, will be permanently informed on the amount of money, will be able to select the fund, or to change it. What is more important: no one will pay some other person's pension.

There will be two systems of administrating private pensions; pillar II (obligatory) and pillar III (not obligatory but stimulative as far as economizing is concerned).

People who are less than 35 years old and who for 4 months since the law was passed haven't added to a private pension fund will be randomly distributed to one.

At retirement the client will be able to benefit from three pensions: one from the state –due to his contribution to pillar I, the second from the obligatory pension fund, but privately administrated – pillar II and the third from the private pension fund, pillar III⁴. The first two are paid by a state agency. Its role is to organize the amounts of money into the two systems mentioned, according to the client option for pillar II. The third will be paid directly to the administrator of the private pension fund.

In the case of the voluntary system, the tax payer can choose to receive the total amount at the end of the contract. The contribution of each person to pillars II and III is definite and in case of death the sum of money will be inherited.

The tax payer of a private pension fund can move to another one (there are approximately 3,500 private funds existing in Europe) for free after the first 2 years, in case he's not satisfied with the efficiency of the private pension fund he is currently affiliated to-or by paying a penalty if he decides to move earlier. No matter how the efficiency of the private pension fund evolves, it is incumbent for its' administrators to pay a private pension which cannot be smaller than the equivalent of the taxes paid by the insured person, diminished with the commissions and legal penalties.

The launching of the private pension system is meant to save the population from the bankruptcy of the public pension system .But, in order to have the desired effects, the percentage decided upon to be paid by the tax payers from the wages fund must be correctly chosen.

³ I a n c u , A. (coord.) - *The Economic Development in Romania- competitiveness and UE integration*, chapter 4 (*Reformation of Social Protection*, Romanian Academy Publishing House, 2003, pag. 132

⁴ ***, On private administration of pensions – interview realized by *Bilanț Magazine* (december 2005-january 2006) with Eugen Voicu, Certinvest President, pag. 117

The choice of an unrealistic percentage of transfer from the wages fund within the public system to the private one can induce high administration costs of the private pension fund, and also an increase of the deficit to the public pension system.

During the last 16 years, the National Pension House budget has been poor, the total deficit, without subvention, has had sums over 100 % between 1995-2006 (the highest being in 1998). Also, the real average pension calculated as a percentage of the average pension in October 1990 has surpassed over 75 %.

A situation similar to the one in Poland must be avoided. The bad situation has resulted from a fault in collecting funds (only 30% out of the total sum have been invested, and the obtained profitability has been related to the value of the whole fund), as well as the immediate or delayed consequences: the growth of the administration costs.

The example of Chile should be followed, his state being the first to have reformed the pension system. The Chilean system is different, but the structure of the private pension fund portfolio (state titles, bank accounts, corporative shares and obligations, investment funds and foreign investments), as well as the removal of the age limit like leaving the public pension system has led to obtaining an average rate of profitability of 11% over the last 20 years.

Despite the fact that initially there has been an 8 % deficit to the pension system, Chile managed to find the right way of financing: the diminution of the governmental expenses and of funds obtained from private enterprises. At the same time, it was permitted to the contributor the escapade from a public pension system due to the use of the coupons which represented the estimated value of their contributions to the public system. The amounts of money were automatically transferred to the private pensions found to which every contributor have chosen.

The reformation of the pensions system in Chile brought about other positive effects: the private pensions funds became the principal investor on the market and developed the activity on this market. The private pensions funds had almost 50% from the GDP. The private pensions system does not produce inflationist phenomena because they have a high potential and because of the liberalisation of migration from the public one to the private one, and the state only supported the pensions for the rest of Chile's contributors, approximately 1 percent. However, to achieve Chile's performance, Romania should transform the public pensions system into a private one. The new pensions systems should abide by the laws and the regulations of the liberal market.

Only by doing so can we have the opportunity to pass beyond the blocking resulted from the ageing population and from the reduction of the number of tax payers to the pension system. Our country also joins the worldwide's tendencies from the ageing population's point of view and the increasing number of pensioners. Forecasts reveal that, until 2050, the average hope of life, at the global level, will rise to 75 years old, while the fertility will continue to decrease from 2.6 children per family – as it is nowadays – to 2 children. According to the latest forecasts, in 2050 16 million people – Romania's population at present – out of 16 million will be pensioners.

Over the last 15 years the retirement rate constantly raised. In 2003 it registered 171, 43% of the persons retired in 1990, after a climax reached in 2003 of 173, 36 %. At the end of 2004 a diminution of the number of retired persons was registered. At the time there was a number of 6 212 000 pensioners.

This evolution of the total number of pensioners is partially determined by the economic and social measures taken in Romanian economy which in their turn produced essential changes in

the socio-economic structure of the population. Not to forget the diminished natality rate and an ascendent mortality evolution.

From 1990 in order to prevent an unemployment raise, the retirement age and the tax payment period lowered down. The number of employees was reduced to half, compared to 1990. The number of the persons working in the economic field was reduced too.

Starting with 1997 the number of pensioners has surpassed the number of employees.

From 1995 the Social insurance fund has registered an annual deficit of 3 % from its annual income.⁵

The level of social insurance benefits as well as agriculturer's pensions went down in real terms in the past years. In 1997 the most dramatic situation was registered; the pension level of an agriculturer was of 26,6 % from the medium pension of social insurance. In 1997 the medium pension of social insurance was of 37% from the value registered in 1990.

The actual medium pension level in the period 1990-2005 under the value registered in 1990. This can be explained by the fact that starting with year 2000 a new pension system was adopted, but also due to the descendent evolution of the prices index and of the economic development rate registered in Romania.

The expenses from the social insurance fund have started growing from 1994, gradually surpassing the level registered in 1991.

In this context new sources must be found necessary to the payment of pensions and social insurance. Moreover new possibilities of raising these payments/revenues are requested in order to balance inflation effects.

The value of a pension point starting with September 2003 was brought up to date by a 2, 655 index. By applying measures of social protection, the medium pension from the state was raised to 1 953 676 and the pension for age limit to 2 652 511 lei.

In 2004 pensions were successively raised and the law concerning pension raise and correlation was adopted. Figures prove a significant raise of the amounts paid to retired persons but they are not important since the basic amounts were extremely low.

Thus in 2004 the medium pension for a person was of 2 514 630 lei/month while an agriculturer pension was of 792 666 ROL/month. The ratio between the average pension of social insurance and the medium salary was of 37, 5% in 2004; the ratio between the monthly average pension and the average salary of agriculturerbe s was much lower at the same time. Covering the necessities of these categories is still far from a normal level of survival.

Starting from this matter of fact and from the previsions made by the organization for Cooperation and Economic Development in order to avoid the failure of the pension system at European level, a solution might be prolonging professional active life.

Legislative measures adopted should have in view the elimination of the temptation of unemployment in the case of aged persons or of considering them disabled. At the same time, there must be created conditions for implementations of pensions with private capital as a means of completing and balancing public pensions.

In 2006 the percentage of those who have an investment product for the private pensions in Romania was 7 % of the active population. This percentage is smaller than the average one of the region which was 20 %.

⁵ ***, On private administration of pensions – interview realized by *Bilanț Magazine* (december 2005 - january 2006) with Eugen Voicu, Certinvest President, pag 117

Pension funds with private administration should attract more and more tax payers, offering them a large variety of possibilities of “investment” of the attracted amounts.

The investing portfolio should consist not only of investments on monetary, financial, currency markets, but also on other markets such as real estate market, not only on internal markets, but also on external markets too.

These funds should be subordinated to economic laws of market. Those who opt for this kind of funds should be convinced that the invested sums will have an increase at least equal with that of an own medium or long term investment (for example in a real estate activity or in investment in state titles).

However, pension funds which have been capitalized and privately administered have one more obstacle to overcome: the mistrust of the population which sees them through the recent “history”: FNI, FNA, CARITAS, etc. This obstacle can be overcome also by a better transparency of the activities of these types of funds.

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Sistemul de pensii - fundamentul asigurărilor sociale

Rezumat

Reformarea sistemului de pensii în România pornește de la problemele multiple actuale cu care acesta se confruntă. După anul 1990 au fost operate schimbări în vederea integrării în cadrul asigurărilor sociale de stat a categoriilor integrate în alte sisteme de asigurări. Articolul de față încearcă să surprindă câteva dintre consecințele acestei efervescențe legislative, precum și unele aspecte ce reflectă impactul situației economice a țării noastre, în ultimii 16 ani, asupra categoriilor de pensionari și asupra veniturilor acestora.