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Overcoming the Crisis of the Social Insurance System – between Theory and Practice

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Abstract

Current pension systems around the world are in crisis, being unable to bear the burden of financial support. The significant increase in the number of pensioners together with the decrease in the number of taxpayers represent the most important factors that have generated this situation. The pension system can be saved by implementing private pensions that generate capital, changing this system in a network of social security and a tool for economic growth. In order to bring the pension issue to the attention of the Europeans, 2012 was declared the European Year for Active Ageing and Solidarity between Generations.

Key words: *the crisis of the pension system, tax evasion, raising the retirement age, pension pillar, pension fund deficit*

JEL Classification: *H55*

Introduction

Social security is a main element of the social security system which aims primarily at the compensation by benefits, money or services, of the inability to obtain wages in certain situations (temporary or permanent inability to work, old age, etc.). The social security system is based on collecting resources (funds) from the insurants in a contributor system and on distributing benefits/ insurance premiums to the contributors or their successors, in accordance with the provisions stated in the insurance contract.

Social security introduction is assigned to the conservative reformers Von Bismarck and Von Tauffe who issued the first insurance laws in Germany, between 1871 and 1891. The German pension system designed by Bismarck about 120 years ago is considered the first official pension system in the world. At that time the system was widely appreciated because it was based on reasonable contribution rates and it provided a substantial income to those who retired. For this reason, this system became a pattern for the majority of social security systems around the world.

The Current Situation of the Pension System

"One of the priorities of a modern state is to create a legal framework that allows the organization of a viable and realistic pension system, able to provide a living as decent and carefree as possible to its citizens who reached the retirement age."[1]

Worldwide the pension system undergoes a crisis that tends to become more acute. Currently, in the countries of the European Union, financing the pension system generates impressive costs of about 8-10% of the GDP just to keep themselves afloat. This situation *"demonstrates that the budget for the state pensions is no longer sustainable in its current form and requires major reforms. As for the amounts allocated for social protection, Romania has one of the lowest levels of social protection expenditures in Europe."*[2] Thus, with 339 Euros per capita, our country spends 20 times less than the euro zone average.

The issue of financing the pension system represents one of the greatest challenges of the XXI century, due to the aging conditions that the world faces today as a result of rising life expectancy and decreasing birth rate. In this context, experts warn that the current global crisis will be exceeded ten times in intensity by a future pension crisis if the policymakers do not become more committed to reform pension systems.

Saving the pension system can be achieved by implementing private pension plans, generating capital, so that social security systems of older people should represent not only a social security network, but also a tool for economic growth. In this regard, Dutch economists Bovenberg and Van Ewijk proposed the development, on the basis of private pension funds, of a specific capital market for investment financing, which would be regulated at EU level but equilibrated through an effective risk distribution between the Member States.[3]

After a half-century communist period, Romanians got used to a powerful state that is still expected to assume increased responsibilities for most current social issues, including an important problem, that of the elderly. Nowadays, the relation between the individual and state responsibilities in ensuring the elderly needs to be reviewed and adapted to the requirements of the era in which we live.

A Brief History of the Pension System Evolution in Romania after 1990

It is necessary to have a retrospective look at the steps crossed by the pension system in Romania in order to observe the progress that has been made and to project future actions.

During 1990-2012 there were *four stages* of reforming the pension system:

*Stage I (*1990-2000) with legislative measures, some positive for financial sustainability of the system, other more populist, to support certain categories of people or to avoid some popular movements;

Stage II (2001-2004) characterized by the appearance of Law No.19/2000 on the public pension system which provided:

[1] V a s i l e , V. (coord.), Analiza evoluțiilor politicilor sociale in U.E. în ultimii 3 ani – pensii suplimentare/private si impactul îmbătrânirii populației, *Studies, strategies and politics*, European Institute from Romania, no.4/2011, p. 55
[2] V o i n e a , L., *Adevărul despre cheltuielile de protecție socială*, Yellow Gondolin wordpress.com
[3] B o v e n b e r g , A.L., V a n E w i j k , C., *Good Pension Embrace and Share Risc: Private Pension Stimulate EU Capital Market*, CPB Netherlands Bureau for Policy Analysis, 2011

- gradual raising of the retirement age from 57 to 60 for women and from 61 to 65 for men, until 2014;
- gradual increase of the minimum contribution period for both sexes from 10 to 15 years, until 2014;
- pension calculation based on a point system that takes into account the incomes achieved over their entire career;
- giving extra points to stimulate labour market participation after meeting the cumulative retirement.

Stage III (2005-2010) characterized by:

- the implementation of a multi-pillar framework legislation for pensions, materialized by the creation of the CSSPP (Private Pension System Supervisory Commission) and the implementation of pillar II and III;
- consolidation of the first pillar, materialized by eliminating non-contributory pension benefits, such as: farmers' pensions, child-raising and childcare allowances, sick leave;
- recalculation of about 4.5 million pensions in payment;
- introduction of guaranteed minimum social pensions fully funded by the state budget.

Stage IV (2010-2012) characterized by:

- implementation of the Law No.263/2010 on the unitary public pension system, mainly materialized by:
  - increasing the standard retirement age;
  - integrating people from the special system to the unitary public pension system;
  - establishing the pension point value;
  - discouraging early retirement;
  - discouraging abusive disability retirement.

The Crisis of the Pension System

Current pension systems around the world are in crisis, being unable to bear on its own the burden of the financial support for future generations. Birth and fertility rates have alarmingly dropped, the level of increase is negative, the life expectancy at birth is low and migration has reached a level record. In addition, a significant increase in the number of pensioners while reducing the number of taxpayers represents an important factor of the financial difficulties that the public pension system is confronted with and accelerates the need to implement private pension systems. In this context, public pension systems in Romania must function as a decreasing component while capitalization systems will amplify, thereby showing positive effects.

The aim of the new system is to ensure a pension that supplements the one offered by the public system by collecting and investing part of the individual social security contribution by the employer.

In order to ensure the necessary funds to sustain the pension system, most experts support the adoption of a complex mechanism comprising:

- a public system (pillar) with mandatory participation, aimed at reducing poverty among the elderly;
- a private system (pillar) based on funded mandatory deposits;
- a private system (pillar) based on funded voluntary deposits;

Within this mechanism, the first pillar would cover the distribution, the second and the third would cover savings and all three together would achieve a co-insurance able to meet the many risks that the elderly are facing. According to experts[4], in order to exit from crisis, we need measures to allow the active and healthy ageing of employees, to reduce the early retirement schemes, as well as to increase the retirement age.

The Pension System in Romania

The structure of the pension system in Romania includes the 5 pillars recommended by the World Bank.

- *Pillar zero*, publicly managed, financed from general tax revenues, redistributes incomes for the groups that have lower incomes, with the help of certain testing means that take into account both revenues and assets. The amount of non-contributory benefits is based on state guaranteed minimum income, which is adjusted by the government according to the inflation.
- *The first pillar*, financed by the "pay-as-you-go" method, publicly managed, is an earnings related system, in which benefits are calculated based on revenues earned by the insurant in his whole professional career and are determined as ratio between his salary and the average wage.
- *The second pillar*, newly introduced, privately managed and fully funded, is also an earnings related system. In this system, benefits are calculated according to the individual contributions and investment earnings, benefits payments procedures are being adopted.
- *The third pillar* is an optional pillar, privately managed, fully funded, based on defined contributions that aim to provide people with a mechanism that supplements the paid benefits within the first and second mandatory pension pillars.
- *The fourth pillar* provides medical care for the elderly as part of the national heath insurance system.

Currently, the model of social insurance in Romania is not sustainable because economy lies on a reversed pyramid in the sense that 3.1 million private sector employees support 15 million budgetary employees, children, pensioners and individuals who benefit from welfare.

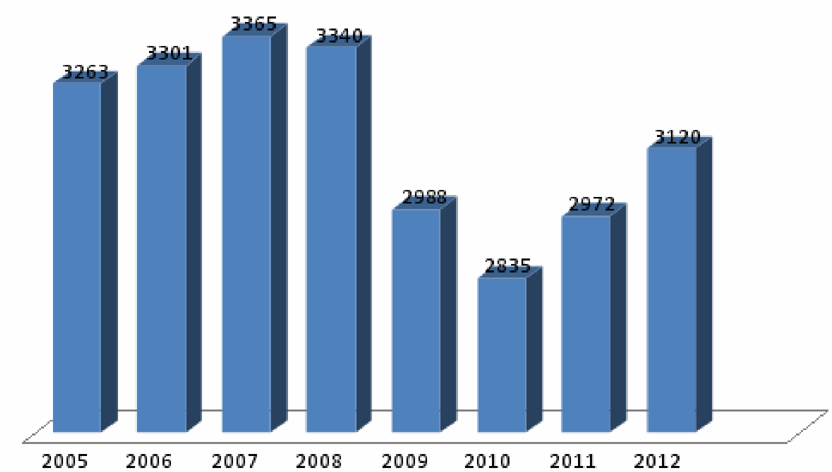

Diagram 1. Evolution of the number of employees in the private sector
Source: National Institute of Statistics

[4] Joint Employment Report Council of the European Union, March 2011, 7396/11, E.P.S.C.O.

The statistics in Diagram no.1 on persons employed in the private sector in the period 2005-2012 illustrate the increase in the number of employees from 3.263 thousand to 3.340 thousand persons in 2008, followed by its diminution to 2.988 thousand in 2009 until 2010 when a number of 2.835 thousand was recorded, as a direct consequence of the economic crisis. In the following period, the situation has improved, recording an increase of 2.972 thousand employees in 2011 and continued until 2012, when a number of 3.120 thousand employees was recorded.

Given that this category represents the support of the entire social security system, the leadership, represented both by the parliament who elaborates laws and by the government who implements them, must take decisive actions to stimulate job creation in this sector.

One of the factors that contributed to the crisis of the pension system in Romania is *“the relatively significant gap between the actual age of retirement and the standard one, of 7 years for men and 3 years for women.”*[5]

In Romania, for a population of 19 million inhabitants, the 4.3 million employees (3.1 million in the private sector and 1.2 million in state companies) support 5.3 million pensioners, which means that an employee supports 1.24 pensioners. This situation mainly occurred due to the mistakes that the government has made after 1990, which allowed working people to retire before the age of 55 and former army workers and other similar systems in which case the retirement age limit is 40. In this context, Romania has a unique situation in Europe, being the only country where the pensioners outnumber the employees.

In Poland, for a population of 38 million inhabitants, the 13.8 million employees (10.2 million in the private sector and 3.6 million in state companies) support 7.3 million pensioners, which means that an employee supports 0.53 pensioners, or in other words, 2 employees support a pensioner.

The situation of the surplus/deficit of the pension fund from 2005 to 2012 reveals an alarming condition of the pension fund in the sense that the deficit increased every year, starting with 2008 and reaching a deficit of 13.834 million lei in 2012, which is 3.2 billion Euros.

Diagram 2. Evolution of surplus/deficit of the pension fund from 2005 until the present day

Source: National Institute of Statistics

Mitigating this deficit could be achieved by increasing the number of employees in the private sector and by reducing the number of pensioners who fraudulently receive pension. There are counties where disability pensions are more than half of the total pensions, which is abnormal.

[5] G h e ț ă u , V., *Speranța de viață a românilor pensionați in anul 2009, Abordare longitudinală,* Romanian Academy, National Institute of Economic Research, Bibliotheca Demographica, no.10/2010

According to statistics, the number of disability pensioners increased from 208 thousand in 1990 to 892 thousand in 2008 (4.29 times). Where the situation was carefully analyzed, it was found that more than half of invalidity pensions were fraudulently obtained.

To this deficit it was added the way in which military pensions were recalculated, in the sense that the principle of contribution was not observed as it would have been normal and the pension expenditures increased instead of decreasing.

Another cause that generated the increase of the deficit is giving state aids to employees, Romania being the only European state where a person receives social assistance. In 2012, from 4.3 million employees 1.8 million were socially assisted, which resulted in a waste of public funds that could have been spent, for example, in order to create new jobs.

As regards the employment in the budgetary system in 2005-2012 we observe an increase from 1.238.129 persons in 2005 to 1.398.757 in 2009, which was a waste of public money by hiring made on the basis of clientele system. The emergence of the economic crisis forced the state to reduce, even where it shouldn't have, the number of employees so that it reached 1.190.870 in 2012. This situation, reflected by the data from diagram no.3, shows the negative influence of political factors on the economy, which resulted in useless and wasteful consumption of funds that could have been used for investment, thereby contributing to broadening the tax base, the reduction of unemployment, economic growth.

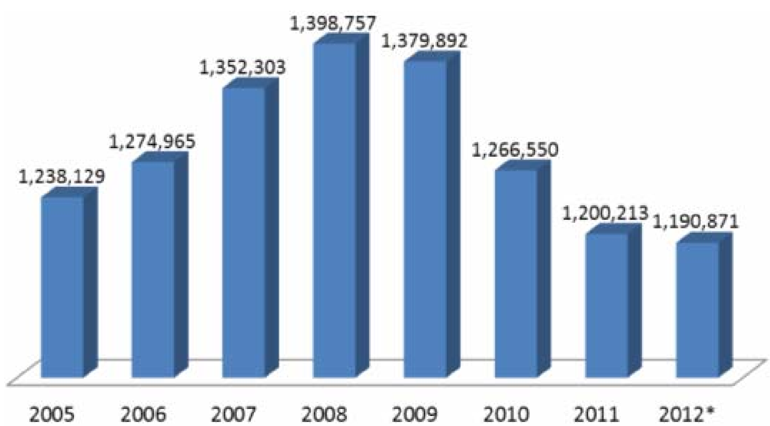

Diagram 3. Evolution of the occupied number of positions in the public sector in 2005-2012

Note: * - end of June
Source: National Institute of Statistics

Tax evasion represents another cause that increased the deficit of the pension fund. According to information provided by the Labour Inspectorate, in June 2012, the General Record of Employees registered 5.513.496 employment contracts (officials, freelancers, employees from Administration and internal Affairs and employees from the Ministry of National Defence are not included in this registry) for which social insurances are being paid in terms in which the working population was 10 million and the number of unemployed was 426.000.

According to calculations made by the Fiscal Council, 2.3 million Romanians are illegal workers and over 630.000 are employed with a minimum wage. If we consider the number of 2.3 million illegal workers and multiply by 180 Euros (about 750 lei net), the state loses approximately 100 Euros/employee per month by not collecting the income tax and the social contributions (pension contributions, health, unemployment, etc.), that is about 2.76 billion Euros/year.

Although the new Labour Code of 2011 tightened penalties for employers who use illegal work (imprisonment from 1 to 2 years or penal fine, penalty received by the employer who hires more than 5 persons without signing employment contracts), the number of reported jobs has very slightly increased (only 4% of jobs were brought to surface in 2011, compared to 2010).

Exit from Crisis

The experience of developed countries in the European Union where public money is better spent showed us that it is necessary to take action regarding the retirement conditions. In this regard, experts recommend that the policy on retirement should consider a few rules, such as[6]:

"- avoiding excessively long periods of retirement;
- eliminating penalties for people who work after reaching the standard age of retirement;
- reducing the level of pensions on fair actuarial basis for the personnel who retires early, except for those who are truly disabled;
- establishing the same retirement ages for both men and women;
- eliminating the special schemes that provide early retirement for privileged groups;
- avoiding using retirement as a remedy against unemployment;
- regular increase of the retirement age as life expectancy increases."

Indexation of Pensions, between Desires and Possibilities

On January 1st 2013, through O.U.G. no.1/2013, the indexation of pensions by 4% was decided in order to modify the pension system. According to government sources, in 2013 the pension point value increased from 732.8 to 762.1 lei, while in 2014 this figure will again be indexed to 100% of the inflation rate plus 50% of the actual growth of the average wage recorded in the previous year.

From pensioners' point of view, this measure is welcome as it increases incomes, but seen from the point of view of economy, this creates an important structural imbalance, given that there are efforts to reduce the general government deficit. The fact that the Parliament votes to increase the pension point over the actual possibilities of the economy to supply amounts of money to the pension budget leads to major imbalances, continuously amplified.

In order to avoid such situations in the future, it is necessary to find a balance point between the economic possibilities to allocate certain amounts for pensions and the pensioners' needs. This difficult situation that has come was generated by setting the arbitrary point of retirement, followed by filling with money from the state budget, where it was considered necessary. In order to automatically balance the pension budget *"the technically correct solution would be the transparent allocation of an amount to pay the pensions and its partition on the principle of heat cost allocators (individual score compared to total score) from where the value of the pension point should result"*.[7]

Conclusions

In order to overcome the crisis in which the social insurance system in Romania is today, it is necessary to promote a coherent strategy, adequate to the challenges of a sustainable social security system, suitable to demographic and economic trends.

In order to build a social security system to meet the existing and future requirements, we need convergent efforts from the government, the business environment and the civil society, while

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[6] D u m i t r u , I., *Reforma sistemului de pensii din România*, Doctoral thesis (abstract), Bucharest University, Faculty of Law, p. 20.
[7] P ă l ă n g e a n , D., *Meandrele indexării pensiilor, in* "Economistul" no.2/2013, p. 18

for its correct and efficient implementation, the political class must rise above the group of interests.

To this end, it is necessary to strengthen the pension system by mainly developing private pensions in line with EU recommendations, taking into account both the specific conditions existing in Romania and those practices that proved their viability in the developed countries.

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8. *** Law no.263/2010 on the unitary system of private pensions published in Of. Gazette No.852, part I, 2010, updated.