Pension system in Romania. Long term imbalances and inconsistent policies[1]

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Abstract: *Public policies on retirement, both in Romania and in other EU countries, have been and still are conditioned by numerous short-term budgetary constraints and by long term major sustainability problems. Alongside objective, demographic developments known in all European countries, support systems for the elderly are facing numerous constraints, both due to government policies marked by fiscal indiscipline and lack of consistency of decisions and, hence, the credibility phenomena caused by the phenomenon "the captive politician of a redistributive policy model".*

Modeling support institutions for pensioners by political actors was most of the times the expression of elections marked by Weberian instrumental rationality and not by wertrationalität, using the axiom - guide for the behaviour of decision makers to "meet social interests in order to come to power" and not by the concern for a more long term efficient trans-redistributive approach. This paper aims to pursue the most important imbalances that characterize the public pension system in Romania, expression of decisions determined by aggregating in group individual preferences and not by both rational and ethical analysis, without redistribution centres.

Keywords: age dependency ratio, PAYGO systems, imbalances

JEL Classification: *H55 - Social Security and Public Pensions*

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1. Sources of imbalances between the european homophonous and the distinct national mark

In the last two decades, EU public policies regarding retirement have been reviewed systematically and sometimes radically. Virtually none of the countries within the common European space has not excluded from its public policy objectives the public pension system reform. In the meantime, starting in the 1980's and acting globally, the World Bank has assisted 68 countries to reform public pension systems, with over 200 loan and credit programs (World Bank, 2006). It is generally accepted that most of the completed reforms were not due only by the desire for doctrinal relocation of the role given to public policies under the influence of what is known to be the Washington Consensus (Williamson, 1990), but rather the common changes of developed countries and some of the emerging ones, regarding the nature of demographic growth, effects of new social behaviours, well documented by sociologists in the last three decades.

PAYGO pension systems, with defined benefits, allow a balanced fiscal approach of the link between contributory generations and the beneficiary ones only if there is some form of age dependency ratio(the percentage of people over 65 years in the population aged between 15 and 64 years). Lower the number lower the share of population over 65 in the total population aged 15 to 64 years is. In 2010 it reached the rate of 1 to 3.8 and for 2050 it is forecasted a rate of 1 to 2 in the EU countries. Therefore the critical mass of occupied people who financially support pensioners has decreased and it will continue to decrease dramatically.

In Table no. 1 this trend can be seen as it appears in 2010 and the forecast for 2050.

Table no. 1

Countries	2010	2050
EU (27 countries)	25.92	50.16
World	11.7	25.4
Romania	21.37	53.81
China	11.32	38.8
Japan	35.1	73.8
Poland	19	40
Spain	25	70
France	26	49
Germany	31	53
US	19	40

Source: Eurostat and World Bank, 2011

The major negative trend of dependence will severely increase after 2030, when the baby boom generation will reach retirement age.

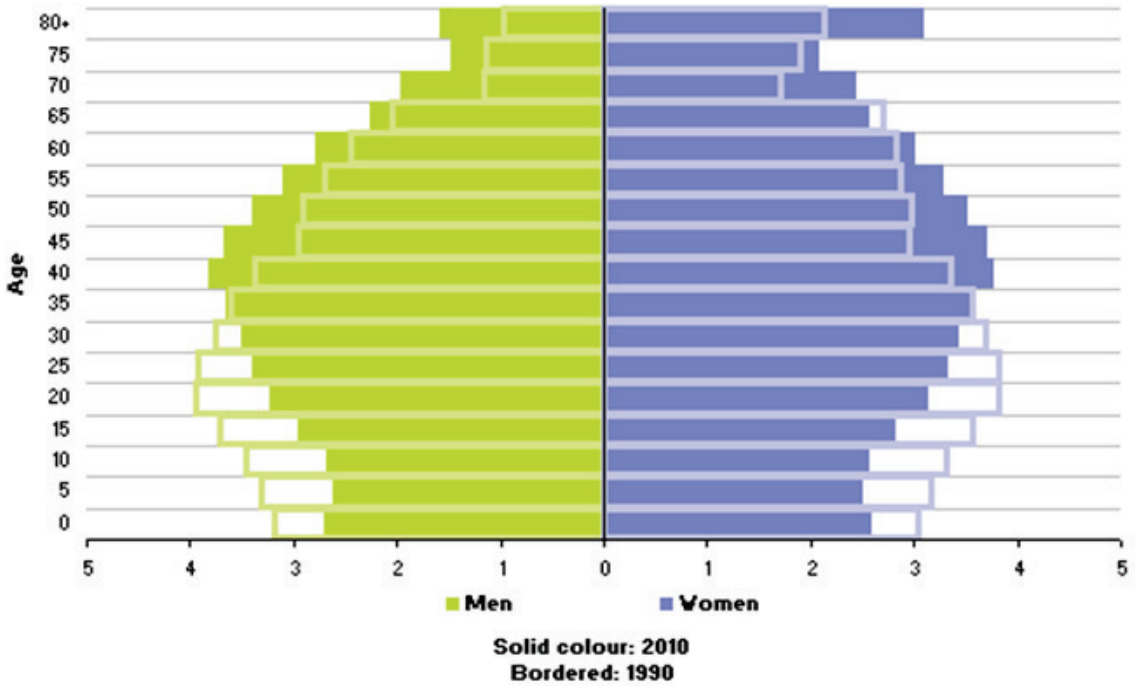
There are three major reasons for this dramatic change: increased longevity, earlier retirement ages and slower population growth, or shortage in the future population.

The evolution of the fertility rate (continuous decrease) and life expectancy (constant growth) have made the current developments in dependency rate well anticipated and with sizeable effects, hence the wide acceptability of more determined steps towards reform.

Increasing longevity is one of the important factors that have imposed the PAYGO reform. Both in Europe and the U.S., as well as in China, demographic changes over the past 50 years and the ones projected for the next 50 years highlight the transformation of the age structure from the pyramid shape - which highlights the growth of young population - to a rectangular shape which emphasizes the contraction of youth population and the expansion of the old one's. This trend is less evident in the U.S. than in other economic areas due to higher fertility rates and a greater number of emigrants.

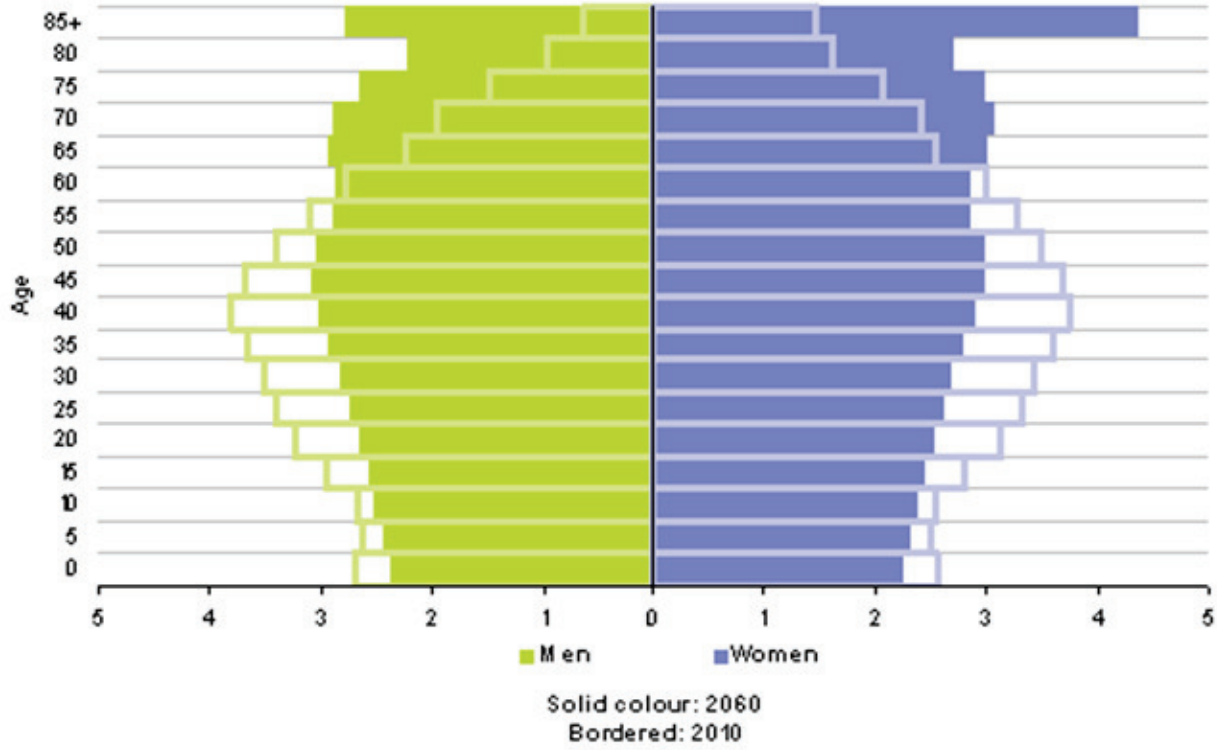
The first two following graphs show trends in age structure of the EU in the years 1990-2010-2050. The trend shown by these graphs is that of maintaining the drastically reduced fertility rate (below the generation replacement rate) and a major increase in population over 65 years, thus of the retirement age (EU 15 countries have the highest longevity rates of the world).

Fig. no. 1



(1) Excluding French overseas departments in 1990.

Fig. no. 2



(1) 2010, provisional; 2060 data are projections (EUROPOP2010 convergence scenario).
Source: Eurostat (online data codes: demo_pjangroup and proj_10c2150p)

For 2050, in Romania, demographers' expected a number of people over 65 years amounts to approximately 7.4 million (43% of the population) from a total of about 17 million people, compared to the 5.7 million pensioners in early 2011 which represented 27% of the country's population. This trend is accompanied by current low fertility rates and identical projections for coming years the 21st century. Romania has one of the lowest fertility rates in the EU (1.39 children per couple), surpassed only by Germany, Hungary and Latvia, well below the generation replacement rate (2.1 children). This makes the median age in Romania to be 38.7 years, (38.5 in the EU), compared to the world median of 20 years[1] . Forecasts for 2050 raise this median age to 48 years, meaning the aging thesis is getting more shape.

The above developments regarding the ageing of population have important implications over workforce evolution. Negative population growth as well as developments in the labour market, allow us to make observations on the evolution of employment and the number of retirees.

Table no. 2 reveal in Romania a decrease of the employment rate over the last decade. Between 2000 and 2011 the decrease was about 8% compared with a slightly increase in the EU 27 for the same period.

[1] CIA World Factbook

Table no. 2 Employment rate 15-64

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU (27 countries)	62.2	62.6	62.4	62.6	63	63.5	64.5	65.4	65.9	64.6	64.1	64.3
Euro area (16 countries)	61.4	62.1	62.3	62.6	63.1	63.7	64.7	65.6	66	64.7	64.2	64.2
Romania	63	62.4	57.6	57.6	57.7	57.6	58.8	58.8	59	58.6	58.8	58.5
United States	74.1	73.1	71.9	71.2	71.2	71.5	72	71.8	70.9	67.6	66.7	NA
Japan	68.9	68.8	68.2	68.4	68.7	69.3	70	70.7	70.7	70	70.1	NA

Source: epp.eurostat.ec.europa.eut, 2012

Table no.3. Employment rate at 55-64 – 2010

EU 27 countries)	46.3
Euro area (17 countries)	45.8
Romania	41.1

Source: Eurostat, Key figures on Europe, 2011

The employment rate within the 55-64 group is also low at the EU 27 level, of about 46%, as it can be seen in the table no. 3. With the new pension reforms, the level of employment at 55-64 is expected to raise at around 60% from this age group.

Future pensions funding also depends on the support ratio (people in the age group +65, in the labour force). In 2005 EU 25 had 35 people in the age group 65+ per 100 people in the labour force. By the year 2050 – at constant labor / labour force participation rates and with immigration this support ratio would reach the level of 72 people in the age group 65+ per 100 people in the labour force.

Low employment rate within this segment but also in the hole 15-64 (only 58%)[2] segment leads to systemic disequilibriums: lost of GDP, assuming the actual trend in work productivity (48.9%) than EU average in 2010) and also the small labor force participation and a financial disequilibrium because of the small amount of contributors to the social insurance budget which raise the problem of who will sustain the futures defined benefits of the pension system.

The next two tables show the evolution of GDP on market prices and the evolution of the new entrants as pensioners in different periods of time (which represent different governments).

[2] Eurostat, Key figures on Europe, 2011

Table no. 4. Evolution of the number of pensioners

Perioada	1990-1992 Left government			1993-1996 Left government				1997-2000 Right government			
Pensioner no. Evolution	+ 623.000			+960.000				+576.000			
Number of pensioners (thousands)	3577	4034	4200	4392	4917	5187	5352	5524	5702	5894	6110
GDP (billionUSD)	40.8	28.9	19.6	26.3	30	35.4	35.3	35.2	38.1	35.6	37

Sursa: BNR, 2011, INS for number of pensioners

Table no. 5. Evolution of the number of pensioners

Perioada	2001-2004 Left government				2005-2008 Right government				2009-2011 Right government	
Personier no.evolution	-106.000				-357.000				-134.000	
Number of pensioners (thousands)	6311	6342	6274	6205	6042	5785	5726	5685	5689	5555
GDP (billion USD)	40.1	45.8	56.9	73.1	98.6	121.9	166	200	161.1	161.6

Source: BNR, 2011 for GDP, CNPP for number of pensioners

The relationship between the evolution of GDP and the number of pensioners reflects a strong inverse correlation between the two indicators in the period 1990-1992 because of the started policies of economic restructuration (GDP decline correspond to an increase of the pensioners), only in the first months of 1990 the number of pensioners increasing by around 400,000 people as an results of Law 50/1990. The decline of the GDP is also determined by the diminishing labor force through unemployment which increased with about 600.000 persons from 337440 to 929019). In the second examined period, even if the economy restarted the number of pensioners still increase with about 960000, which is explain because the gain in productivity are realized by reducing labor costs and maintaining retirement as a substitute policy to unemployment (the unemployment decrease at the and of this period with about 500.000).

In the third period 1997-2000 period, for a GDP growth of about 5%, the number of pensioners increased by 576,000 as it is with the number of unemployed with about 120.000 .

On the hole, the ninth decade is the one in which retirement can be seen as a deliberate loss of labor productivity (thus of GDP), through discretionary public policies, based on the incidence passed forward principle (or, for the sustainability of PAYGO systems with defined benefits it is important to track income trends: if they grow due to increased productivity, then there will be higher incomes available for redistribution; if revenues fall then the amounts likely to be redistributed also diminish.

The ninth decade is also characterized by the **decline in GDP** due to defensive

restructuring (companies' productivity increase was achieved by cutting down the number of employees). .

An interesting phenomenon, documented for the1993-2005 period by Brown and Earle (2007), relevant to the unsustainability of the pension budget was the one concerning the productivity evolution of **new firms** entering the economy. They found that the average new firm entry in productivity growth is very low; even if **net entrants** had brought a higher productivity rate (up to 50% of productivity growth) they could not cover the whole economy productivity losses. Moreover as the two authors suggest, new firms entering the market have had in the first year a productivity of up to 30% lower than the incumbents but surpassing them after two years with about 20% the productivity of incumbents. After four years the increase productivity of these companies remains the same as the incumbents', and after seven years, new entrants to incumbents productivity remains high but not by much (10%), within a survival rate of 60%, which reflects a system effect (follows the average). On the other hand, ***the cross effect*** (gains in productivity from the expansion of employment shares in high productivity growth firms and the reduction of employment shares in low productivity growth firms)[3] is negative, which means that an increase in productivity is not associated with the increase share of the firm in employment. This shows a „defensive restructuration" and not a "redistributive" one (shift in employment between sectors).The construction sector productivity is one good example of the fore mentioned: in 2006 the productivity in this sector was 300% higher than in 1989, but the reduction in labor force in this segment was the biggest in the Romanian economy 65%[4] . As a result, in Romania even the labor productivity increased constantly it remains high below the EU average, 50.2% in 2008 and the salary augmentation (and correlative the pension contribution) on those sector with higher productivity cannot compensate the losses of contributors from the other sector of economy.

The **number of employees** is also relevant for the current imbalances of public pension system and for the futures ones without changing policies: between 1989 and 2010 the shrink was of 50% from 8.2 millions to 4.1 millions. Adding at this the evolution of the real salary (for the afore mentioned period increase only of 24% with a major reduction between 1990-1997 (in 1997 the same salary as it is in the 1969) we can add a new tile at the explanatory pattern of public pension system imbalances.

Corroborating these figures with the ones previously mentioned, we can make the following comments: (1) the 90's have been defined by approximately 3.6 million job losses due to structural adjustments, whilst "transforming" intro retirees about 2.4 million people, which has brought to the stage of the public pensions sustainability problem. (2) The reducing employment trend is positively correlated with the economic growth

[3] http://siteresources.worldbank.org/ECAEXT/Resources/Innovation_Inclusion_Integration2, p.40

[4] **Herman, Emilia, Georgescu, Maria-Ana,** *Correlations between the average wage and labour productivity in romania in thecontext of the socio economic sustainable development*, p.2, ICELM-3, Tîrgu Mureș, Romania, 2008

period (in 2002 the level from 1989 had been reached) and strongly correlated with the economic crisis: at a GDP decline of 7% there has been recorded a decrease in the employed population of approximately 8%. This diminishing employment trend has further continued in 2010; at a GDP growth of 1.5%, employment fell by about 6%, suggesting the lack of confidence in the "reboost" economy and, hence, the lack of major investment projects in terms of employment. Moreover, in 2010, foreign direct investment has been declining with about 25.6% compared to 2009, and in 2009 it was about 48.4% lower than in 2008, according to data provided by the National Bank of Romania. At the same time, the decrease in the employed population sector has been also the result of government policies regarding the adjustment of the public sector through layoffs and retirements.

Another significant indicator for understanding the future pressures on public pension budget **is the number of pensioners.** In 1990 this was 2.6 millions persons, but in the early twentieth century the number of them was 6.1 millions from which a number of 4,2 individuals were social security public budget pensioners and the rest retired farmers (with pensions not related to contributiveness); in 2010 their number was of 5.6 millions, of which 737.000 pensioners from agriculture or having different periods of time worked in agriculture, while in 2011 the number of all pensioners was of 5,5 millions from which only 200.000[5] .

The evolution of the number of pensioners in this period reflects an extremely complex and dynamic reality marked by inconsistent policies. If in the ninth decade lax and fragmented retirement policies were a deflector of some expected social effects of structural adjustment policies of economics (i.e. increasing poverty), in 2000 "developments in pension policies cannot be detached from the ones belonging to the previous period" (Gheţău, 2011). In the ninth decade, the number of pensioners on all categories of social security pensions increased, which marked the evolution of the number of pensioners in 2000. The only declining category of retirements is in the agricultural sector (farmers) with a drop of over 50% compared to 2000, due to mortality.

Stage of pensioners' contributiveness. Ministry of Labour (2011), statistics show a trend of a decrease of retirements on complete contribution in the total number of pensioners. The report also revealed the increase of retirement on age limit and incomplete contributiveness. 1.83 million (approximately 33% of total) have an incomplete contributiveness stage and only 2.60 million (approximately 42% of total) are old age pensioners who have a complete contributiveness stage. These developments have led to a real average retirement age of 52 years and a proportion of 25% pensioners in total population.

With a life expectancy at retirement age of about 23 years - average men and women, on average, a pensioner will receive pension rights for approximately 21 to 27 years - based on gender. Such a constant development will determine the possibility to predict in 2030 a growth to 6.3 million individuals (except special pensions)[6] , meaning 31% of the total population.

All the desequilibrums (natural or

[5] www.ins.ro

[6] **Ghetau, Vasile**, *Cati pensionari va avea Romania in 2030?*, HotNews.ro, mai 2011

artificial) explained above will give us the configuration of the main financial imbalances faced by the social security system.

2, Constant financial imbalances

Demographic evolution and the structural changes in the structure of the Romanian economy together with inconsistent policies in the field of social protection system lead to permanent fiscal imbalances from the mid of the 90. Aging population, reducing tax revenues due to low growth rates, small salaries as a consequence of small productivity are only few of the economic and social evolution which rise the imbalances of public social protection budget and increase both the needs of transfers from the state budget and increasing needs of government borrowing to cope with the increasing deficits.

As it's seen in the table no. 6, public expenditure for social protection represent a large and a constant part of the GDP in EU and the future projections (OECD, 2005) based on hypothesis of unchanged policy parameters show higher levels of public expenditures in the future, a contagion effect, we can say.

Table no 6. Expenditure on social protection (with health expenditures)

Expenditure on social protection										
% of GDP										
Country	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
EU (27 countries)						27,12 225	26,71 441	25,74 323	26,35809	Aprox.26
Euro area (16 countries)	26,675 59	26,80 647	27,37 277	27,77 143	27,673 46	27,71 077	27,34 273	26,79 991	27,46864	Aprox.27
Romania	13,035	12,77 552	13,56 135	13,05 948	12,822	13,43 839	12,81 993	13,55 158	14,25329	11.1%

Source: Eurostat, 2011

Tabel no. 7. Old age expenditure 2000- 2050 forecast

Country	Old age 2010	Old age 2050
EU (27 countries)	13.06	Increase by 3-5% from GDP
Romania	8.4	14.8
France	12.1	14.5
Germany	11.8	13.8
Italy	14.2	14.4
Nederlands	5.2	8.3
Sweden	9.2	10.8

Source: Ageing and Pension System Reform Implications for financial markets and economic policies, November 2005, OECD.

Compared to the EU average, Romania expenditures on old age are particularly low and slightly widening. These does not mean that from a financial point of view the things are better due to the high level of interest rate of the loans (6.7% for the Romanian bond on 10 years).

In the EU countries, expenditure on pensions accounts for aprox.13.6% of GDP, Romania 2010 expenditures on pensions representing 8.4% of GDP, up to 4 percentage points compared to 2001. Among the emerging markets in the EU, Romania also ranks a middle position regarding expenses, but forecasts for 2050 rank us at the forefront of these emerging countries in regards to the share of expenditure on GDP.

The share of social expenditures in the public budget represented 24.9% of budget expenses in 2010, this share being higher by 8.5 percentage compared to 2001 (Preda, 2011).

For 2011, the deficit of the pension budget was 2.7% of GDP, given that in 2009 and 2010 the deficit was 1.5 and 1.3 of GDP, according with Ministry of Labour budget execution.

In numbers, the budget deficit in Romania in 2010 was about 2.5 billion dollars and in 2011 was around 3.5 billion (2.7% GDP), far from expected 6% deficit in budget in 2050;

S@P Report (2010), suggest that if we will have similar evolution in the next years the financial imbalances will grow higher due to: increasing cost of loans to cover the differences between contributions and the level of pensions (interest rate is expected to rise at 8.2% in 2030), the increase in the number of pensioners because of the baby boom generation[7].

According to S@P study, in Romania in the period between 2010 and 2050 the GDP growth will be only 1.9% which indicates the impossibility of funding the pension budgets from the GDP growth, as long as they will increase in the afore mentioned range by 6.4% of GDP

Another major element of the current deficit of public pensions budget is the annual average growth of pensions in the period between 2004 and 2009 (24% each year). The annual average growth of wages was only 15% in the same period and the average real growth of GDP was of 5.4%.

In the analyzed period, the average pension was increased 6 fold, while the wage increased almost 5 times.

To these developments we can can add inconsistent policies in the field of retirement regarding: the change of the retirement age, changes in the calculation of the pension (from percentage of the base wage on the last five or ten years to the points system), special interest groups policies on retirement etc[8]. and also a lax policy on disability pension.

To these we add a low collection rate, from approximately 15 million people of working age, only 4.4 pay pension insurance. In the meantime the number of contributors to the second pillar in March 2012 was 5.6 million (the numbers must be equal).

[7] S&P Global Aging 2010; *An irreversible truth*, 2010

[8] Preda, Marian, coordinator, "Sistemul de asigurari de pensii in Romania in perioada de tranziție: probleme majore si solutii", European Institute of Romania, Bucharest, 2004

Conclusion

National public pension system in Romania is in the middle of important structural reform because of a projected deterioration in public finance in the next forty years. Budgetary consolidation of the pension system it a must not only for the romanian public authorities but for all the EU national authorities. These is for several reasons: (1) ageing population which is not a problem neither of left parties nor of the right ones but a mathematic one. (2) a moral problem, because of the sake of intergenerational solidarity it's beyond of any ethical principles to increase the taxation burden for the future employed generations, (3) because of the need of keeping in the future social peace in a world of dramtic social change.

Germany, 1992, Italy, 1992, 1995, France, 1995, 2003, Belgium, 1997, Netherlands, 2004, Sweden, 1998 etc. have pension system reformed by: changing calculation parameters (pension increase is based on indexing with the inflation rate or with the net salary, introduction of the points system in pension calculation) , introduction of multi-system approach, gender equality concerning the retirement age, diminishing level of the defined benefits, increasing contribution rates etc..

Even with these reforms more remains to be done to put the public pension systems in balance for the next generation and in the same time to preserve the level of the welfare of the old age population as an objective beyond the ideologies.

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