THE PENSION SYSTEM IN ROMANIA

1. THE PENSION SYSTEM – MAIN FEATURES

The pension system in Romania has undergone numerous reforms over the recent years, aimed at improving the sustainability of the system confronted with structural changes of demographic nature in the sense of an increased share of the aged population.

The modified system has three components: Pillar I, Pillar II, Pillar III.

Pillar I of the pension system is the public pension system, which is compulsory, also called the pay-as-you-go system.

The public pension system (Pillar I) gives the right to receive a pension when the retirement age is reached, following a full contribution period for which the duration is stipulated by law.

In addition, the law provides for an early pension or an early partial pension, for a period of up to 5 years before the official retirement age is reached, based on a pro-rata pension right. The early pensions or early partial pensions shall be re-calculated when the retirement age is reached, for the people who meet all the legal requirements and are entitled to a pension for full length of service. The retired who receive pensions for full length of service but continue to work and contribute to the system after having reached the official retirement age shall be entitle to an increased pension re-calculated on an annual basis.

In 2006, the public pension system counted 5.808 million pensioners out of a total 6.043 million-strong retired. The difference of 0.235 million is formed of retired from the Interior Ministry, the Defense Ministry, the Romanian Intelligence Service SRI and the Justice Ministry. These latest pensions are paid directly from the state budget based on different pension formula. The pensions of independent farmers, after being paid from the state budget, were included, as of 2006, in the Social Security Budget.

This system is 99% financed from the social security contributions paid by both employers and employees. The employers' contribution rate is established based on the work category, and in 2007 it stood at 19.50% for the normal work conditions category, while the individual contribution rate is at 9.50%; the total social security contribution is 29%.

Pension Pillar II (privately-managed compulsory pensions) consists in the development of an obligatory system of individual pension funds which are in the portfolios of private companies.

Pension Pillar III is formed of voluntary contributions of the insured to different pension funds or insurance companies specialized in the field.

2. REFORM OF THE PENSION SYSTEM

According to the Ruling Program, a consistent package of legal measures has been applied in the social security field as of 2005; these measures are focused on three main objectives:

- the financial consolidation of the public pension system and ensuring appropriate revenues to the retired within the system;

- the rebuilding of the social security public system by eliminating a number of non-contributive right types and outsourcing a number of indemnities supported from the social security budget;

- the introduction of new financing and management alternatives of a number of pensions such as the privately managed capitalized pensions, aimed at ensuring a secure and decent revenue to future pensioners.

The reform of the **first pillar** (also called the public pension system) is aimed at creating a more equal distribution and improving the actual contributions-rights ratio, which triggered the increase of the general level of the rights received by the insured. At the same time, the continuous focus is the improvement of the system's long term sustainability.

To allow pensioners to enjoy the benefits of the economic growth, the Ruling Program provides for an increase of the pensions by approximately 30% in real terms by 2008, as compared to the level in 2004.

To this purpose, in 2005 the pensions established according to the legislation in force before April 1, 2001 were re-calculated.

- **The pension re-calculation action** and the payment of rights resulted after the re-calculation regulated by GEO 4/2005 on re-calculation of the pensions in the public system, originating in the old social security system, approved by Law 78/2005, were carried out in 4 steps: March, July, September and December 2005;
- During the four steps, the pensions were re-calculated in a number of 3,554,474 files. **As a result, a number of 1,614,405 persons (i.e. 45.38%) scored higher than the previous score for the pensions being paid at that moment, and therefore received additional amounts during 2005.** The average pension for this category of beneficiaries went, after re-calculation, to 330 RON, up by 21.3% as compared to the level before re-calculation at 272 RON.

The main features of the new system are: the standard retirement age shall gradually increase by 2014 to 60 yrs for women (from 57 yrs) and to 65 yrs for men (from 62). During the same period of time, the minimal contribution period went up for both men and women from 10 yrs to 15 yrs and a new calculation formula was introduced based on a scoring system which takes into account the actual revenues for the entire period of service (the previous method was concentrating the revenues to a limited period of the full service of the employees) and includes re-distribution calculation items based on the contribution principle. The revised calculation method consists of cumulating the monthly revenues and turning them into scoring points, with the average number of points being multiplied by the value of the pension point as established by law.

An essential element of the payg system is the outsourcing, as of 2006, of a number of rights which are transferred to the health system (the leave and indemnity for temporary work inability, rights for illness prevention and recovery of the work capacity, leave and indemnity for sick children care) with the new system including up to around 95% the payment of pensions and other rights provisioned in the public pension system.

It is necessary to mention that the reduction of the social contribution rates has been a constant concern of the Romanian Government. Thus, the social security contribution rate for the employer went down from 22% in 2005 to 19.75% in 2006 and further to 19.50% in 2007, and it is still to go down by an additional 1.50% by end-2008, to arrive at 18%. The table below shows the evolution of the rates in 2005 – 2011.

Table 1 The level of the social security contribution rates in 2005 - 2011

	2005	2006	2007	2008	2009	2010	2011
The contribution rate payable by the employers	22.00	19.75	19.50	18.00	18.00	18.00	18.00
The contribution rate payable by the employees	9.50	9.50	9.50	9.50	9.50	9.50	9.50
Total contribution rate for normal work environment	31.50	29.25	29.00	27.50	27.50	27.50	27.50

Within the policy aimed for improving the welfare of the retired, the pension point is to go from 31.2% of the average gross salary in 2007 up to 37.5% of the average gross salary as of 2008. The increase of the pensions in 2008 shall be caused both by the increase of the percentage granted from the average gross salary and by the increase resulted after the average gross salary would be raised in 2008 as compared to 2007.

In order to sustain the pension Pillar I, on the background of simultaneously reducing the contribution rates, implementing the Pillar II and increasing the pensions, it became necessary to adopt a number of measures aimed at making up for the expected negative impact on the revenues to the social security budget.

Hence, the following measures were envisaged to change the legislation in force as of 2008:

- Remove the restriction of the 5 average gross salaries in connection with the payment of the social contributions;
- Enlarge the taxable basis, by taking into account, for establishing the contribution, the average gross income and not the average gross salary, as currently;
- Introducing new obligatory categories of taxpayers (sole associates, managers, directors).

In addition, a substantial positive influence will be driven, over the next period of time, from improved macro-economic indicators, the increased average gross salary and a higher number of employees.

The focus will also be on improving the collection of the current amounts owed by the employers and the arrears.

In the Ruling Program for 2005-2008, the Romanian Government undertook to adopt and implement a package of measures aimed at ensuring a better life quality for the retired, by introducing two new components in the pension system, Pillar I and Pillar II, obligatory and optional and privately managed.

Pillar II - the obligatory pension system which is privately managed.

The reform of the pension system in Romania provided for the introduction of Pillar II, as of January 1; this pillar will give the opportunity for an supplementary pension in addition to the public system pension, which means the pensioners are to receive additional revenues.

Pillar II includes the privately-managed obligatory pensions. The forming mechanism for these pensions consists of reducing the individual contribution rate and transferring the amounts resulted to the privately-managed pension funds.

Starting January 1, 2008, the 2% share of the social contributions payable by the employers under 35 shall be channeled to the privately-managed pension funds. For the employees between 35 and 45, this contribution is optional. The amounts channeled to the privately-managed pension funds shall increase gradually over a period of 8 years, by 0.5% , until they reach the level of 6%.

The base of the Pillar II shall be the commercial companies established exclusively for the purpose of managing the pension funds, also called managers.

The Private Pension System Supervising Commission is the institution specialized for authorization, regulation and prudential supervision. This commission has the responsibility to check on the way the managers meet their obligation of prudentially investing the assets of the privately-managed pension funds, especially taking into account the following rules:

a) invest to the benefit of the participants and beneficiaries;
b) invest in such way to ensure the security, liquidity and profitability thereof;
c) invest primarily in instruments traded on a regulated market;
d) invest in derived financial instruments only for reducing the risk of the investment or for facilitating the efficient management of the portfolio;
e) diversify the assets in an appropriate way to avoid excessive dependence on certain assets, issuers or group of commercial companies and to avoid concentrated risks on the assets as a total.

The contributions to a pension fund shall be recorded in individual accounts, which gives the participant the ownership of the net assets, with the money to be invested by the managers, according to the pension scheme to be clarified in the legislation.

Each pension fund will have to attract at least 50,000 people. The persons who fail to sign up with a fund manager within the deadline stipulated by law shall be automatically assigned to fund managers based on an aleatory formula.

Managers have the responsibility to manage and invest the assets of the pension fund, pay the rights to the participants and beneficiaries, according to the law, keep record of and update the individual accounts, as well as other responsibilities stipulated by the legislation in force.

The individuals' personal assets may be used only for paying a private pension, on the date when the public pension system's requirements for full service retirement are met.

The Pillar II contributions are estimated to go up to 803 million lei in 2008.

Pillar III – the privately managed optional pension system

The provisions regarding the occupational pension schemes – Pillar 3 – came into effect on January 1, 2005; still, they proved to be impossible to operate for a number of reasons, not the least of them being the incompatibility with the European legislation.

These were turned into optional pension schemes to ensure one available system to a large category of participants and allowing mainly the individual participation to the detriment of the collective labor agreements.

The amount representing the contribution to the optional pension funds is, for each participant, deductible from the monthly average gross salary income or any income assimilated thereof, in the limit of an amount representing the equivalent of 200 euro in one fiscal year.

The amount in contributions to the optional pension funds of any employer proportionally with the participation rate thereof is deductible as well, for taxable profit purposes, in the limit of an amount representing, for each participant, the equivalent of 200 euro in one fiscal year.

According to the legal provisions regarding the optional pensions, the investment of the optional pension funds' assets is tax exempt until the rights are duly paid to participants and beneficiaries.

According to the estimates, around 500 thousands people are expected to join Pillar III during the first year of implementation (2007).

The pension may be obtained at age 60. However, similarly to Pillar II, the details regarding the calculation and the payment of the pension have not been completed yet.

3. THE SUSTAINABILITY OF THE PENSION SYSTEM

Romania faces serious demographic challenges with regard to the sustainability of its pension system. In 1990-2005, the dependency ratio for the pensioners went down from 3.43 to 0.77 and the trend is expected to continue as such in the future years. The general occupational shares for aged working persons make the demographic challenges even more serious.

In 2006, the occupational rate for the population at the working age (15-64 yrs) was 58.8%, while the category 55 – 64 yrs has an occupational rate of 41.75% and the category over 64 an occupational rate of 14.2% only.

It is obvious that between 1996 – 2006, the most rapid reduction of the occupation share was seen in the population over 64, the decrease of which from 32.3% to 14,2%. is a matter of concern.

To this purpose, sustained efforts are necessary for Romania to come close to the 70% , a figure which represents the target occupational rate determined in the Lisbon Strategy for the year 2010.

Below are the standings of the occupational rate of the population, by age categories, between 1996 – 2006.

Table 2 Occupational rate of the population, on age categories, between 1996 - 2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Occupational rate 15- 64	65.80	66.35	64.73	63.95	63.60	62.90	58.00	57.80	57.85	57.35	58.80
Occupational rate 55- 64	50.08	52.13	51.28	50.25	50.08	48.83	37.68	38.08	36.88	39.43	41.75
Occupational rate over 64	32.30	33.80	34.88	36.10	35.88	35.60	18.50	17.93	14.90	14.58	14.20

For men and women, in 2006, the occupational rate was 58.8% for the age category 15 – 64, with 64.7% for men and 53% for women.

The table below shows the occupational rate of the population, for men and women, aged 15 – 64.

Table 3 Occupational rate of the population between 15 – 64, individually for men and women

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Occupational rate total	65.80	66.35	64.73	63.95	63.60	62.90	58.00	57.80	57.85	57.35	58.80
Occupational rate - men	72.95	73.20	71.35	70.03	69.50	68.53	64.05	64.10	63.65	63.90	64.70
Occupational rate - women	58.78	59.55	58.18	57.98	57.78	57.35	52.03	51.53	52.10	51.55	53.00

The occupational rate of the population by age category (15 – 64 yrs) went down between 1996 – 2006 by 7 percentage points, i.e. from 65.8% to 58.8%. In can be seen that the down trend of the occupational rate on this age segment is more accentuated in men, with a reduction of 8.2 percentage points, whereas in women, in the same period of time, the reduction is of only 5.8 percentage points.

The occupational rate for women in the category 15-64 yrs on the labor market stood at 53% in 2006. However, women show a higher poverty risk during the retirement period as compared to men, mainly as a result of the wide discrepancies in the occupational degree, but also because of the low scoring given to women for the non-contribution times (such as child care leaves).

We need to mention as well the fact that Romania counts approximately 1.3 pensioners for each employee – contributor to the social security fund.

No data regarding the poverty distribution on age categories up to 65 is currently available and this should be calculated in order to assess the poverty on different age groups , especially in the case of pensioners over 65.

The Eurostat 2005 figures on the poverty of Romanian retired showed a poverty rate of 17.2% for the pensioners over 65. The poverty level have gone done by several percentage points over the recent years.

In the age category over 65 with a poverty risk, 20.8* of the women are under the poverty threshold, as compared to only 12% of the men in the same category of age.

In average, in 2006, the average level for the full service pension as compared to the gross average salary stand at around 26% .

Starting 1995, the payg system saw several deficits, supported by transfers from the state budget. However, in 2006, the result of the budget exercise showed a surplus due mainly to the reduced social expenditures as a consequence of the outsourcing of rights on a short term and the outsourcing of the farmers' pensions. In 2006 the Romanian public pension system accounted for 5.67% of GDP.

One of the reasons for the increased deficits in the public pension system was the rapid growth of the number of pension beneficiaries in the 90s. Between 1990 and 2002, the number of beneficiaries in the public pension system went up from 3.4 million in 1990 to 6.2 million in 2002 when the maximum level was reached. However, in 2006, as mentioned above, due to the changes in the financing source for the retired farmers and the pensioners benefiting of other occupational pension systems (the army, the police, the justice and cults) the system had to pay the pensions to only 4.6 million retired.

The difficulties the current pension system is confronted with are generated by the demographic pressure, by the changes in the legislation, which allowed the number of early retired to go up (in a move to stimulate the occupation of young people), but also by the rapid growth of the number of retired for disability reasons. All the above have also led to a decrease in the number of contributors to the public pension system.

The other important factor in connection with the deficit of the pension fund is the collection of contributions. The employers refusing to register the actual number of their employees is a problem in Romania. Out of potential 15.6 million people having the working age, only 5.3 million currently contribute to the public pension system. Out of the 5.3 million, a large number (especially individual employees) pays only a fraction of their actual earnings in pension contributions. One serious problem continues to be the non-registered self-employed and farmers.

As an example, in 2001, the National Pension House forecast, as a result of the application of Law 19/2000, that the obligatory pension scope would go up to 1.1 million self-employed and farmers and 0.5 million working exclusively based on civil convention and unemployed. Still, the coverage of the past 5 years after the implementation of first pillar was in average 100 thousand self-employed and farmers.

Most of the independent farmers don’t currently pay any contributions and it is likely they rely on the social welfare at old ages, since they don’t have any contribution work record, whereas the current retired from agriculture do have records of contribution period. Moreover, there is an extensive underground economy (estimated at 1-2 million people) where no contributions are paid, leading to these persons with a very little potential pension or not pension at all when retirement comes.

Another feature of the Romanian work force is a large group of emigrated workers (estimated at 2 million people). While many of these will contribute to the social security system in the host country – and if any mutual arrangements they will benefit of their contributions when retired – a still significant group works in the grey economy and does not contribute to either the foreign or the domestic pension systems, which makes them potentially vulnerable to little revenues when retired.

As we have showed, another source of concern for sustainability refers to creating a new pre-financing development for pillar II, which is to come into effect in 2008. Re-channeling a percentage of the social security contributions to private pensions brings two potential challenges to the overall system, as the change from a full pay as you go system implies a reduction in the available funds to the current pensioners in order to be able to start accumulating the individual rights for the current workers and the apparition of potential deficits of the payg system, but as we showed fiscal measures to fight the negative influences have been taken.