THE PUBLIC PENSION SYSTEM COMPARATIVE STUDY BETWEEN ROMANIA AND GERMANY

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Abstract

Pensions are the main form of protection to citizens by the state social insurance. This paper aims to build a comparative study of the main categories of pension granted in the public pension system - the old-age pension in Romania and Germany. In an attempt to identify possible causes of the significant differences that exist today between the old age pension received by a Romanian and a German pensioner, this paper makes an analysis of key aspects regarding the settlement of public pension systems of the two states. Therefore, we will make a comparison between the main sources regarding the establishment of state social security, namely contributions due by employees and employers, how a pension is granted and how the public pension is calculated (Pillar I).

Keywords: *public pension system, old-age pension, social security contributions, contribution stage, pension point*

JEL Classification: H53, H55, P52

Introduction

Pensions represent the main form of protection to citizens by the state social insurance. They consist of monthly entitlements to be granted to persons who, for various reasons, such as accidents, illness, disability, reaching a certain age, etc.., can no longer achieve an income for themselves, or to those left without a financial supporters after their death.

This paper aims to build a comparative study of the main categories of pensions granted in the public pension system - *the old-age pension* in Romania and Germany[1]. The present study will not take into account retired farmers as their

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[1] The German pension system was the first formal pension system in the world, designed by Bismarck almost 120 years ago, becoming a model for many social security systems in the world. It was also designed to ensure a standard of living after retirement similar to that achieved during the active life. Therefore, the German pension system may be rather similar to a system of "old-age insurance" than a system of "social security".

pensions are stipulated under different laws[2] compared to the pensions stipulated under the law regarding the public pension system and other entitlements. Also, in the western lands of Germany, public servants have a different pension system, which will not be subject to this comparison.

As members of the European Union, Romania and Germany have, at least at an official level in the case of Romania, an active social policy. For both countries, the term - "social state"[3] in their fundamental laws, the social state being compelled to "take measures for economic development and social protection, likely to ensure to their citizens a decent living"[4]. The right to receive a pension is stipulated as fundamental right of citizens.

However, while in Germany, the average social pension exceeds significantly, in some cases, the amount of 500 Euros, in Romania the average social pension was, in July 2009, around 250 Euros. At such a level of average net pension, we cannot talk about providing a decent living for Romanian pensioners.

In Germany, the average pension varies from East to West. But there is also a gender difference in the value of pension. In the Western region, men have an average pension of 976 Euros and women - 465 Euros, while in the East region, the pension for men reaches 1056 Euro and for women – 663 Euros. The explanation for these differences is given by the longer periods of employment in the former RDG compared to RFG. Another explanation is that in GDR there is no distinction between pensions granted to public servants and those granted to other categories of employees. However, in Germany, at present, public servants have their own pension scheme, differently regulated.

In what concerns the level of yearly expenses made for public pensions, Romania registered in December 2008, 4,688 million social pensioner, out of which over 3 million were pensioners for old age (with complete or incomplete stage)[5], the yearly expenses for pensions representing 7.3% of the GDP, while in Germany – a country having a population four times bigger than the population of Romania, the total number of pensioners was around 24.6 millions[6], the expenses for the public pensions representing around 11,5%[7] of the GDP.

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[2] In Romania by means of the Law no. 263/2008 regarding the pension system and other entitlements for farmers, published in the Official Gazette no. 775/2008 and in Germany, the farmers' pensions are regulated at the level of each federal land.

[3] According to art1 paragraph (3) of the Constitution of Romania: "Romania is a lawful, democratic and social state..."and according to art 20, paragraph (1) of the Constitution of Germany: "The Federal Republic of Germany is a democratic and social state"

[4] Constitution of Romania, title II, art.47

[5] The website of the National Chamber of Pensions and Other Entitlements, www.cnpas.org (27.03.2009)

[6] The website of Deutsche Rentenversicherung Bund, www.deutsche-rentenversicherung-bund.de (30.05.2009)

[7] The website of OECD, www.oecd.org (30.05.2009)

1. Sources regarding the establishment of the state social security

Both in Romania and Germany, the main source of the state social security funds is represented by the contributions paid by businesses and institutions, calculated by applying percentage rates on their gross salaries, and by the contributions paid by insured individuals.

It is a system based on the *principle of social solidarity between generations* (German: "Generationenvertrag"; English: "Pay as you go"), the term for a supposed generational contract under which there is ensured financing of the state social security by people still in employment.

In Romania, we have taxpayers in the public social security system[8], as follows: insured individuals, who owe individual contributions to the social security system, employers, people who are elected or who are appointed in the executive, legislative or judicial authority, during their office, and members of cooperatives from an organization of handicraft cooperatives, the National Employment Office, administering the unemployment insurance budget, and any others who enter the social insurance contract.

The social security contribution rates differ according to working conditions (normal, extraordinary or special), as they are approved yearly by the state social insurance budget law.

According to the law of the state social security[9], starting with February 2009, the social security contributions are established as follows:

- 31.3% for normal working conditions owed by employer and employees, out of which 10.5% owed by employee and 20.8% owed by employers;
- 36.3% for normal working conditions owed by employer and employees, out of which 10.5% owed by employee and 25.8% owed by employers;
- 41.3% for normal working conditions owed by employer and employees, out of which 10.5% owed by employee and 30.8% owed by employers;

The share of individual social security contribution includes the rate of 2% related to privately managed pension funds, established by Law no. 411/2004 on privately managed pension funds, republished, with amendments and completions.

In Germany, the institution similar to the National Chamber of Pension and Other Entitlements (CNPAS), dealing with the administration and management of the public pension system is the German Union for Pensions (Deutsche Rentenversicherung Bund), which coordinates, at federal level, the chambers of pensions created locally.

At present, the contribution to the public pension system is 19.9%[10], out of which 9.95% is owed by the employee and 9.95%, is owed by the employer. In

[8] The law no. 19/2000 regarding the pension system and other social security rights, published in the Official Gazette no. 140/2000, as subsequently amended and completed.

[9] The law of the social security budget for 2009, no. 19/2009 published in the Official Gazette no. 122/2009

[10] idem 6 (27.04.2009)

Germany, the public pension system does not provide any differentiation of the social security contribution rates depending on working conditions, however there is a difference regarding the maximum value of this contribution. Thus, while the western lands, this value has been, since January 2009, 5400 Euro, in eastern lands, it is limited to 4550 Euros.

2. Conditions for old-age pension

To receive an old-age pension, the taxpayer must meet two cumulative conditions*: to have the standard pension age and to complete the minimum contribution stage in the public system.* Thus, the old age pension, as its name suggests, is provided to persons who reach the age when it is considered that there is no normal working capacity, provided that they have made the minimum contribution in the public pension system. These conditions are required to be met both in the state social insurance system in the Germany and Romania.

Given the aging population (*Figure 1 and Figure 2*), all over Europe, and the current financial constraints, most European countries (including Romania and Germany) have initiated reforms of their public pension systems, by introducing parametric changes thereof, which include: increasing the retirement age, reducing early retirement, increasing the statutory contribution and others.

Figure 1: Pyramid of ages – Romania 2050

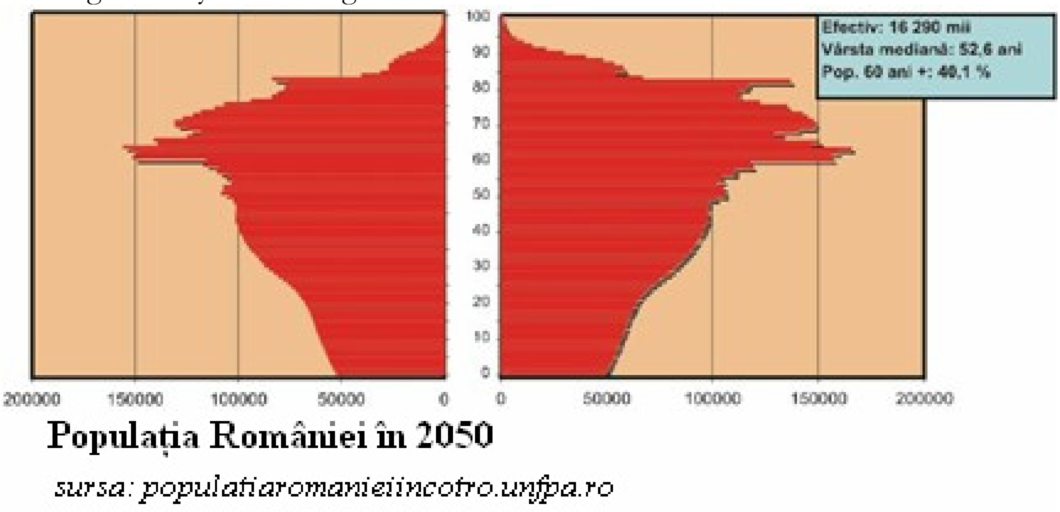
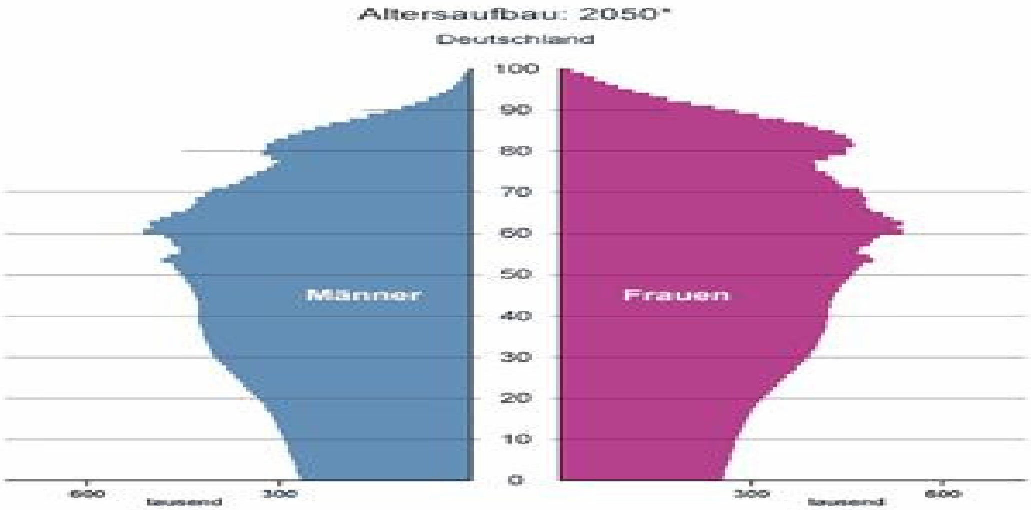


Figure 2: Pyramid of ages – Germany 2050



Populaţia Germaniei în 2050

sursa: www.handbuchderglobalisierung.de

At present (December 2008 – March 2009), the standard age for pension is in Romania 58 years and 6 months for women and 63 years and 6 months for men. They are planned to increase gradually in order to reach in 2015 60 years for women and 65 years for men.

The German pension system does not have any difference of age for gender retirement.[11]. Thus, the retirement age has increased, for starters, from 60 years to 65 years. However, it is provided to increase the retirement age, until 2029, from 65 to 67 years, which increase will affect those born after December 31, 1946.[12].

The second condition to receive the old-age pension is to complete the minimum contribution stage.

At present (December 2008 – March 2009) in Romania, the minimum contribution stage is 12 years for both women and men. It will increase gradually, until 2015, to 15 years. With respect to the complete contribution stage, it is at present 27 years for women and 32 years for men. This stage will increase gradually, until 2015, to 39 years for women and 35 years for men.[13].

In Germany, the minimum contribution stage is 5 years, and the complete contribution stage is 35 years. A difference between the German and Romanian systems to calculate the years of contribution is that the German system does not take into account the years a person has carried out unpaid work (such as university attendance).

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[11] There has been a difference and at present, women born before 1952 may request this type of pension, but with a loss if 0.3% for each month before turning 65.

[12] http://www.fuer-ein-lebenswertes-land.bmas.de (30.04.2009)

[13] The website of the Ministry of Labor, Family and Social Protection, www.muncii.ro (30.04.2009)

3. Pension points and pension calculation

In Romania, the calculation of pensions is governed by section 6th of Law no. 19/2000 on public pension system and other social insurance rights. According to Article 76, the amount of pension is determined by multiplying the annual average score achieved by the insured during the period of contribution to a pension point value (*relation 1*). It increases with the amount of the contribution for health insurance, owed according to the law.

$$\textit{Pension to be received} = \textit{Yearly average score} * \textit{Pension point value} \qquad \textit{(relation 1)}$$

The annual average score achieved by the insured during the period of contribution is determined by dividing the number of points resulting from the addition of annual scores of the insured individuals in the period of contribution to the number of years corresponding to the complete contribution stage according to the legislation in force at the time retirement (*relation 2*).

$$\textit{Yearly average score} = \frac{\sum_{n=1}^{t} \text{Yearlyscore}}{\text{Completecontributionstage}}, \text{ where} \qquad \textit{(relation 2)}$$

t = number of contribution years

The annual score of the insured is determined by dividing to 12 the score of that year resulted from the addition of the number of points achieved every month (*relation* 3). The number of points achieved each month is calculated by comparing the individual monthly gross pay, including bonuses and supplements or, where appropriate, the monthly insured income, which was the base of individual social security contribution, to the average gross monthly salary of the respective month, provided by National Institute of Statistics and Economic Studies (*relation 4*).

$$\textit{Yearly score} = \frac{\sum_{n=1}^{k} \text{Monthlyscore}}{12}, \text{ where} \qquad \textit{(relation 3)}$$

k = number of contribution months

$$\textit{Monthly score} = \frac{\text{Individual gross monthly wage (Monthly insured income)}}{\text{Monthly gross average wage}} \qquad \textit{(relation 4)}$$

Regarding the pension point value, it is determined by the law of social security budget. It is determined by updating the pension point value every December with at least the inflation rate, forecast for the next budget year.

According to Law no. 19/2000, the pension point value cannot be less than 45% of the gross average salary used to substantiate the state social insurance budget. Thus, according to the law of the state social insurance budget for 2009, for the period 1 April to 31 September, 2009, a pension point value is set at 718.4 lei, and starting with December 1, 2009, it should be increased to 732, 8 lei. Given that the gross average salary used to substantiate the state social security budget for 2009 is 1,693 Lei, the minimum threshold of 45% stipulated by art 80, paragraph (3)[14] is not complied with.

According to data from the National Chamber of Pensions and Other Social Insurance Rights, in February 2009, at the level of the pension point of 697.5 lei, the average old-age pension, with full contribution stage amounted to 949 lei (for women, 905 lei), while the average old-age pension, without complete contribution stage, stood at 544 lei, 510 lei respectively, for women[15].

In Germany, the value of the monthly pension is determined as the product between the real value of pensions, pension type factor and the personal retirement point (*relation* 5).

*Monthly pension = Real value of pension*Pension type factor*Personal pension point* *(relation 5)*

where,

The real value of pension represents the monetary value of a pension point. It is periodically adjusted with an index named the Reister factor[16]. At present, the real value of pension is 23.43 Euro, in the lands of the former Democratic Republic of Germany and 26.56 Euro in the lands of the former Federal Republic of Germany.[17]. To remove the differences existing between the two values, which affect the entire pension, it is planned to align gradually the real value of pensions on the entire German territory so that, starting with July 1, 2009, the pension point will increase with 3.38 percents in the former East Germany and 2.41 percents in the former West Germany.

The pension type factor for the old-age pension is 1.

The *personal pension point* is calculated as the product between the point of retirement and input factor. The pension point is given for each year of contribution. The input factor refers to when the applicant withdraws from active life. This factor decreases to 0.3% for each month before retirement and increases by 0.5% for each month worked after that age.

4. Conclusions

In an attempt to identify possible causes to explain the significant differences existing between the level of old age pension received by a Romanian pensioner and

[14] Law no. 19/2009 regarding the state social security budget for 2009, published in the Official Gazette no. 122/2009

[15] The website of the National Chamber of Pension and Other Social Insurance Rights, www.cnpas.org (05.05.2009)

[16] Walter Riester, ministry of labor between 1998-2002

[17] http://www.deutsche-rentenversicherung.de/nn_7112/SharedDocs/de/Inhalt/Servicebereich2/Lexikon/A/aktueller__rentenwert.html (09.05.2009)

a German pensioner, the present study examines the key aspects regarding the organization of the public pension systems in the two states. Thus, we have been considered the main sources of the state social insurance funds, namely the contributions owed by employees and employers, the conditions of the pension and the calculation of public pensions (Pillar I).

According to the information hereby, the main conclusion that emerges is that, at least in the matters under review, the public pension system in Romania is not significantly different from the German one.

In what concerns the social security contributions, both pension systems are the PAYG (Pay As You Go) type, thus relying on a so-called generation contract. The contributions themselves have different values in the two systems, but both of them are shared between employer and employee.

Both in Romania and Germany, the pension is granted only if the applicant meets the legal requirements: achieving a certain age and a certain period of contribution. Both systems use the concepts of "minimum contribution stage" and "complete contribution stage”, but they take different values. The difference between the two systems is the fact that the German system does not provide any differences in terms of the retirement age for women and men.

The pension is calculated based on different formulas. Both formulas, however, have included the concept of "pension point". The pension received differs in both systems depending on the contribution period and the contribution amount, but also on the moment of the retirement.

Ultimately, the amount of state social insurance funds depends primarily on the size of the income of the staff employed as operators and employers pay social security contributions based on such income.

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