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ROMANIA'S PENSION SYSTEM BETWEEN PRESENT RESTRICTIONS AND FUTURE EXIGENCIES

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Abstract

In Romania of today the largest part of available incomes at old age is ensured by pensions, and the most important source is constituted by the public system.

The reform of the multipillar type system – is delayed, already regulated but still partially non-operational - is aimed to the youth of today as future or junior contributors to the system.

Only young persons under 35 **might plan and think** about the level and structure of the intended old age pension. Older generations **do not have a viable perspective** towards financial independence in old age; quite on the contrary they are faced with far more limited options, which include:

- *participation to the public system*, but the expected pensions shall be comparatively far more diminished (in accordance with estimates, the transfer rate in the public system shall be substantially diminished);
- *the contribution to funded private systems*, but on a pretty high background of uncertainty – distrust against market operators, diminished possibilities of contribution due to low incomes, low estimated rates of profitability (for shorter contribution' periods);
- *The recourse to specific social assistance services* for the third age as addition is more a desiderate than an alternative, Romania having a lot more to achieve in this sense.

The projected system is not adequate for persons with low incomes or for the medium term future pensioners

CONTENT

The reform of old age insurance system is a true challenge for Romania, at least for three reasons:

- The **current system**, partially reformed and constructively truncated **undergoes a crisis**;

- due to the **speeding up of demographic transition** and in the absence of a real (economic and social) and **coherent reform**, the old people of tomorrow shall not only be significantly more in numbers, but also poorer and more dependent on the social assistance systems of the state;

- **EU accession and free movement of labour** force requires the creation of an old age security system compatible with the ones of the EU member states, which should stimulate insurance and allow for the transfer of insured amounts.

To a certain extent, **a system adequate to Romania is required, that should also answer to strategic exigencies of economic development and social stability within the European room**[1]. More and more is discussed about the necessity of "national pension reform strategies" to ensure "future evolution of social protection from a long-term point of view, giving particular attention to the sustainability of pensions systems in different time frameworks up to 2020 and beyond" (Lisbon, 2000). In this context, **Romania is still in the stage of building** a multipillar pension scheme. Reforms are still slow paced, a legal frame for a multiple system has been outlined and we find ourselves in the stage of preparing the implementation of private funds.

1. Pensions Reform – much too far from ensuring inter- and intrageneration equity

Transition in the field of pensions' system has lasted now for about 15 years, and **the results are far too modest**. The profound and prolonged economic crisis and the inability to rapidly adjust to the exigencies of a competitive environment, to be dynamic and flexible in achieving the necessary changes triggered an **unjustified postponement and lack of consistency in social reforms**.

Right from the start it was wrongly assumed that **pensions' reform represents a secondary field of interest**. The commitments made to generations in payment regarding old age security ***are not supported yet by a protection system oriented on the future***. Even after all this time, the fundamental laws of old age insurance have been drawn up in a hurry (!) and, for their becoming operational they need to be modified. 11 years of preparation and 4 years of public system reform **have changed the pension into a "time-bomb"**, the pension system being unable to overcome/solve the two fundamental issues: a deficit within the affordability limit (now it varies between 1 and 2 % of GDP) and an inequity regarding comparable pension levels[2].

Pension reform depends not only on the economy evolution, but also on policies promoted in the field of social assistance for persons in special circumstances, or deprived ones. **Third-age**

[1] Even member states having past and present functional and performing insurance systems « are invited to set out clear strategies for ensuring the adequacy of their pension system without destabilising public finances or over-burdening the economy » (source : Communication from the Commission to the Council, to the European Parliament and to the Economic and Social Committee – The Future Evolution of Social Protection from a Long-Term Point of View : Safe and Sustainable Pension, Brussels, COM(2000)622final)

[2] www.baniinostri.ro

individuals retired from labour market are entitled to a protection system, but the extent in which they might benefit from it depends not only on their individual contribution to the system, but also on:

- The *development degree of social protection and assistance systems* for the third age;

- The level of *intergeneration transfers accepted by society*, on the state contribution in supporting most deprived individuals; the practical efficiency of policies in the field.

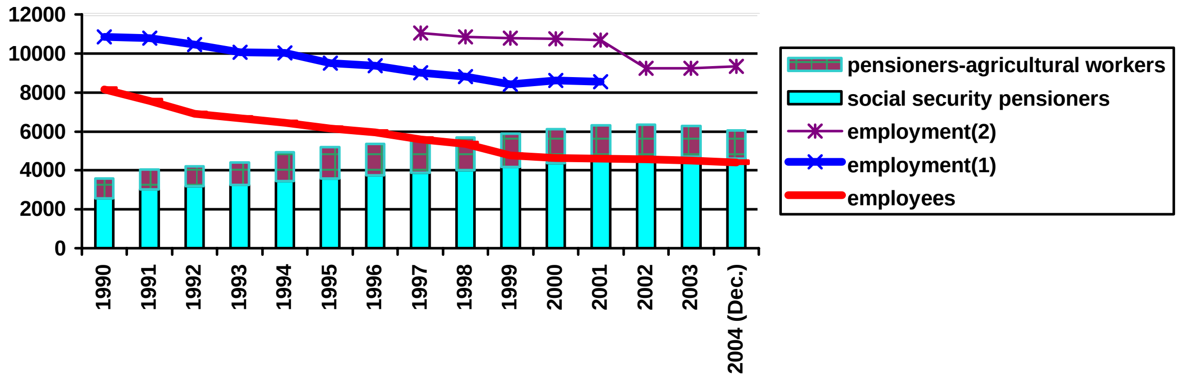
The generation contributing nowadays should not carry a double burden (care for the own future in old age and transition costs) only with the hope of possible higher performances of the system at the moment of benefits payment. If we refer just to the contributions level: a) these are incapable of financing the system – the collected amounts do not cover the current necessities for redistribution; b) the contribution share is encumbering for economic agents stimulating evasion or non-participation to the system.

Thus, the redistributive system which was predominant in past decades proves also in Romania as insufficient and with weaker performances as time goes by. The obtained pensions become more and *more expensive for contributors*, who bear higher and insufficient taxation and also more and more *diminished comparatively to* minimal *necessities* of (today and future) beneficiaries.

As result, in today's society **pensioners are a deprived category** of population, bearing fully (by the size of redistributive pension) the weak economic performance and the errors of social reforms. Additionally, they bear the inequities determined by the mistakes and/or abuses of law-makers and managers of the PAYG system, ***two persons with same training and "history" of participation to the system benefiting of different pensions just because they entered into payment in different periods!***

The working age active generation, potential contributors to the PAYG system, due to the unattractiveness and restrictions of the system participates only to a small extent. From about 10 millions of active persons, only less than a half (employees) are compelled to participate to the system and other categories that might get insured but without being compelled are less numerous. The number of pensioners exceeds the one of employees, so that the effort of present generations to support persons benefiting from pensions increases gradually (Graph 1).

Graph 1 Social security pensioners' dependency on potential contributors to the public pension system



Source: NIS data

Private funded pension appear as a **balance/completion outlet** between necessities and benefits in old age, the individual decision of participating to the system (how much and how long) playing a significant role. In Romania, **participation** depends on a sum of factors (the yet non-functional state of the system, distrust in the performances and, especially, income insufficiency, etc.) which is unviable on short-term, even in some cases impossible to achieve on medium-term. *Not only coherent legal and institutional framework and political resolve are required, but most and foremost a sufficiently developed and stable financial market that should allow to system operators a proper, coherent and performing management of the funds.*

Turnaround solutions for the pension system exist, but a real consensus has not been reached between generations regarding the apportioning of transition costs and there are more and more constraints (budget balance, inflation target, assimilation of acquis communautaire, etc.).

2. Brief History of Old Age Insurances

Although with old traditions in enforcing some public and private social insurance systems, including for old age, Romania is characterised by weak efficiency in the field, inadequate management, which has proven counterproductive on medium- and long-term. **The evolution of the old age insurance system after 1990 is confusing and expectations related to reform measures are over evaluated.** Although important steps were undertaken at legal and institutional level, **the system management is lacking (implementation, functionality and coherence),** with weak performance, generating several sustainable inequities.

2.1. Stages, particularities

Romania is among the first states that, at the beginning of the 20th century, disposed of an old age insurance system regarded as modern in those times. The Nenitescu Act from 1912 provided a compulsory insurance system[3] for old age for the employees of corporations in the Old Kingdom. The insurance system is unified as of 1933 by the Ioanitescu Act[4], but until 1938 the old age pension is excluded from the system. The reintroduction of the pensions in the system was partially, old age insurances for farmers being not included. Nevertheless, experts consider that the ***urban active population in Romania of the 4th decade of the 20th century was covered by social insurances too a high degree*** (L. Margineanu, C. Zamfir, 1999).

The communist regime (Act 10/1949) does practically away with the **private pension system**, the public funds, as well as the private ones being **included in the state budget** which assures the social protection for employees until 1989 under the form of pensions (for old age, invalidity, successors)[5] and of some benefits (sickness, death, maternity). **It was based exclusively on the PAYG system, benefits exceeding contributions.** The system was periodically amended, improved and modernized (Annex 1):

[3] By 1912 on the present Romanian territory were operational 3 insurance laws: one Hungarian for Transylvania one Austrian for Bucovina and the Nenitescu Act in the Old Kingdom. The Nenitescu Act which introduced for the first time the principle of compulsiveness includes also insurances for sickness, maternity, accidents and invalidity for the employees of corporations.

[4]The unification of the system and its management takeover by the state and employers in 1933 is accompanied by non-inclusion of old age pension and of unemployment benefit (I. Marginean, C. Zamfir, 1999).

[5] Because it was considered that the communist regime can and ensures the full employment, unemployment benefits and social assistance allowances weren't acknowledged.

- from 1954 the anticipated pension was introduced, and for hazardous labour groups additional advantages were provided;
- the contributors' sphere was widened in 1959 with agricultural workers and homemakers and/or household staff, aside the system remained workers from agricultural production cooperatives (APC), those from non-cooperativised areas and small handcrafters;
- From 1959 the employment's compulsiveness and of employer's contribution to the **common insurance fund** are instituted. Thereby a higher collection rate of contributions was ensured.
- even though the employment rate was high, and the population on increase, gradually the system enters into deficit; between 1968 and 1972 the rebalancing of the fund was made by diminishing the pension quota (Tufan, 1997);
- After 1977 and up to 1989 the system operated without substantial alterations. The largest part of the population was covered by the old age insurance system but a series of inequities were maintained and sharpened:
    - the complete contribution stage extended with 5 years, gradually contributions increased; benefits remained more advantageous for employees as against other categories of contributors;
    - differentiated calculation of pensions for employees and farmers - the APC members and non-cooperativised farmers were included in the system, but for these the retirement age was higher and the length of service years were calculated depending on labour days and not based on the employment period; received benefits were more reduced;
    - different conditions for accessing pension – age, advantages for employees included in heavy labour categories (obtained reductions of up to 12 years of the pensioning limit)
    - The equity principle of intergeneration transfers was ignored whenever temporary corrections were necessary for balancing the fund. For instance, same activity depending on the period in which it was delivered was included/excluded in different labour categories (normal, heavy and very heavy). In 1989 just a small part of the activities regarded before as being heavy were included in special labour groups.
    - Independent insurance systems appear for handcraft cooperatives, Church, lawyers, artistic creation unions and for those employed in the public order and national defence system.

2.2. 1990-2001(April) Reform or just adjustments?

In the period 1990 – 1 April 2001 the pension system operated in PAYG regime, being subjected to **2 types** of measures: on one hand a sum of actions for "righting the inequities promoted by the communist system", and on the other, some initiatives of "preparing" the pension reforms implementation.

Within the **first** group of changes were included:

- reassessment of the heavy and very heavy labour categories, but to exaggerated wide proportions;

- promoting anticipated pensioning (with up to 5 years) associated with favouring political clientele by temporary derogatory measures from the existing algorithm of pensioning (especially in the period 1995-2001, March);
- granting very easily invalidity pensions of 3rd degree, associated with generous benefits (a large part of these pensioners worked thereafter in the informal economy)
- Repeated change of the pension calculation methodology (in favour of the future beneficiary) and maintenance of high transfer rates, 54 – 85% from the basic wage.

The **second** reform preparation represented, in fact, an awkward attempt to adapt the social security system in assembly to the new economic and social conditions. In the field of pensions, it intended, firstly, to set up a PAYG pillar to ensure old age protection and to maintain the system in financial balance[6]. The main corrections were:

- increasing the employer contribution from 14% in 1989 applied to the wage bill and the employee contribution from 3% of wage rate to 22.33%, respectively 11,67% in 2000
- covering the deficit by transfers from the state budget (only until 1994 the fund has surpluses; the extremely generous replacement rate determined deficits on increase);
- separate administration of the pension fund for some categories of contributors (lawyers, military);
- Continuing activity after retirement is allowed by cumulating the pension with the wage for a period of up to three years.

All these led to inter- and intrageneration inequities, which altered the practical relevance of the social solidarity principle:

- **The connection between the contribution proportions** (in share and duration) **and the benefits' size was profoundly distorted**. There were even situations where the pension share exceeds not only the level of the last received wage, but it is even 20 times higher than the average pension at national level (!).
- **Differentiated indexation leads to a more marked levelling of pensions**, increasing not only poverty among old persons, but also inequity, professional and educational differences as results from the pension level being diminished, vanishing or even reversed (e.g. a low skilled worker receives as payment a higher pension than an university professor);
- Compulsory contribution remains only declarative, while **cashing performance decreases** due to exemptions and instalments for large debtors (they also produce the most anticipated pensioners) and to fiscal evasion. The informal sector of economy is stimulated also because of management inefficiency in the social insurance system overall.

If we would realise a **picture of the system in 2000**, then this **is defined by the following parameters**:

- **the retirement age** is the one of 1989 (60/62 men, 55/57 women), with reductions for privileged occupational groups up to 12 years; anticipated retirement may be done with up to 5 years earlier;
- **the complete contribution stage** – 30 years men and 25 women (the same as in 1977); the minimum stage 10 and 15 years; the low level of effective retirement

[6] The extremely generous replacement rate practiced during the communist regime has created long-lasting imbalances within the system that are felt even today.

age and the increased life expectation have extended the period of benefits payment to about 20 years;

- **the pension contribution is tax deductible**, the employee paying 1/3 and the employer 2/3 and represents in average 37% of the income; the **state covers** from the state budget the fund **deficits**;
- the **contribution collection rate is around 75%** and the contribution is calculated for tax declared wages and not for effectively cashed incomes which are much higher
- **the low participation rate to the system of active population – under 50%**; self employed do not contribute, neither employees with civil contracts; farmers participate voluntary and with a low share (7%), and the economic agents from agriculture, food industry and trade with agricultural products/foodstuff pay a contribution of 2 to 4%;

As regards **benefits**, the average pension in 2000 represented 43.9% comparatively to the one of 1990 (the actual net wage earning was of 58.6%. Pensioners amounted to almost 4.4 millions, employers 4.6 millions and the active population 11.6 millions).

3. Reform of the pension system

As in other transition countries from Central and Eastern Europe, the pension reform in Romania was based on the **World Bank multipillars model.** The redistributive PAYG system was combined with funded contributions managed in public and/or private system.

A series of **support measures** were complementary considered, to ensure on one hand the compatibility of the systems of these countries with the ones of developed countries, and on the other to ensure the "constructive support frame" for the system on long term, respectively: increasing the retirement age (with 5 years), extending the full contribution period (with 5 years), earned-related benefits (up to a maximum ceiling of 5 average gross wages on economy), diminished replacement rates in PAYG system that can be completed by compulsory and/or voluntary participation to occupational and/or private funded schemes.

3.1. Overall scheme. Constructive principles and particularities

Discussions regarding the construction of the general scheme were long and full of controversies (about stages, types of pensions/funds and impact on contributors/beneficiaries, present and future ones). After a decade of preparation/delay, the pension system reform started with the reconstruction of the 1st compulsory pension pillar, managed by the state in the PAYG system. The introduction of private pension was delayed for 4 years, period in which the first pillar was applied only for persons entering into payment after 1st April 2001. Pensioners in payment on the date of enforcing Act 19, received a repeatedly adjusted pension but not comparable with the one of new pensioners. As general observation, the **complementary measures of enforcing Act 19 could not attenuate the effects of postponing the introduction of private pensions and could not solve the problems of the state system on the contrary, it sharpened them.**

In 2001*, by enforcing Act 19,* ***the public pension system*** *was undergoing a crisis and it was believed that the solution was represented by the* ***system reconstruction****. But the truncated enforcement of the Act and the postponement of the other stages of reform determined the deepening and sharpening of the crisis.*

The year 2004 represented a **crucial moment** in pension policy because: on one hand a consensus was reached between the interested parties regarding the shape of the private funded pillars and specific laws were passed, and on the other hand the need was acknowledged of restoring the balances of the 1st pillar and, first of all, of respecting the equity in calculating all pensions.

It should be mentioned that, simultaneously to the activity targeted on creating a multipillar scheme of pension, **there existed a gradually developed life insurance system of the private pension's type** to which participate currently those persons who already understood the advantages, perspectives and viability of the systems based on capitalisation.

The current old age insurance system as designed by the legal and institutional framework is approved (Scheme 1) and bears, naturally, the fingerprint of national particularities and of the moment in which it was built. It is almost impossible to design very clear models, the decisions depending to a large extent on the specifics of each country. Still *no country is absolutely free to choose a certain system or strategy*, the decision factors having to take into account the current situation of the respective country (Barr, 2002).

This old age pension scheme ensures a coherence of the contribution system and a relative flexibility of individual decisions in choosing the benefit "portfolio" for old age. (Annex 2) The four normative acts govern systems able to operate independently. It should be mentioned that the current public system, of a distributive type, due to population ageing and to low occupation, without the pension funds system with capitalisation ***cannot offer decent pensions.***

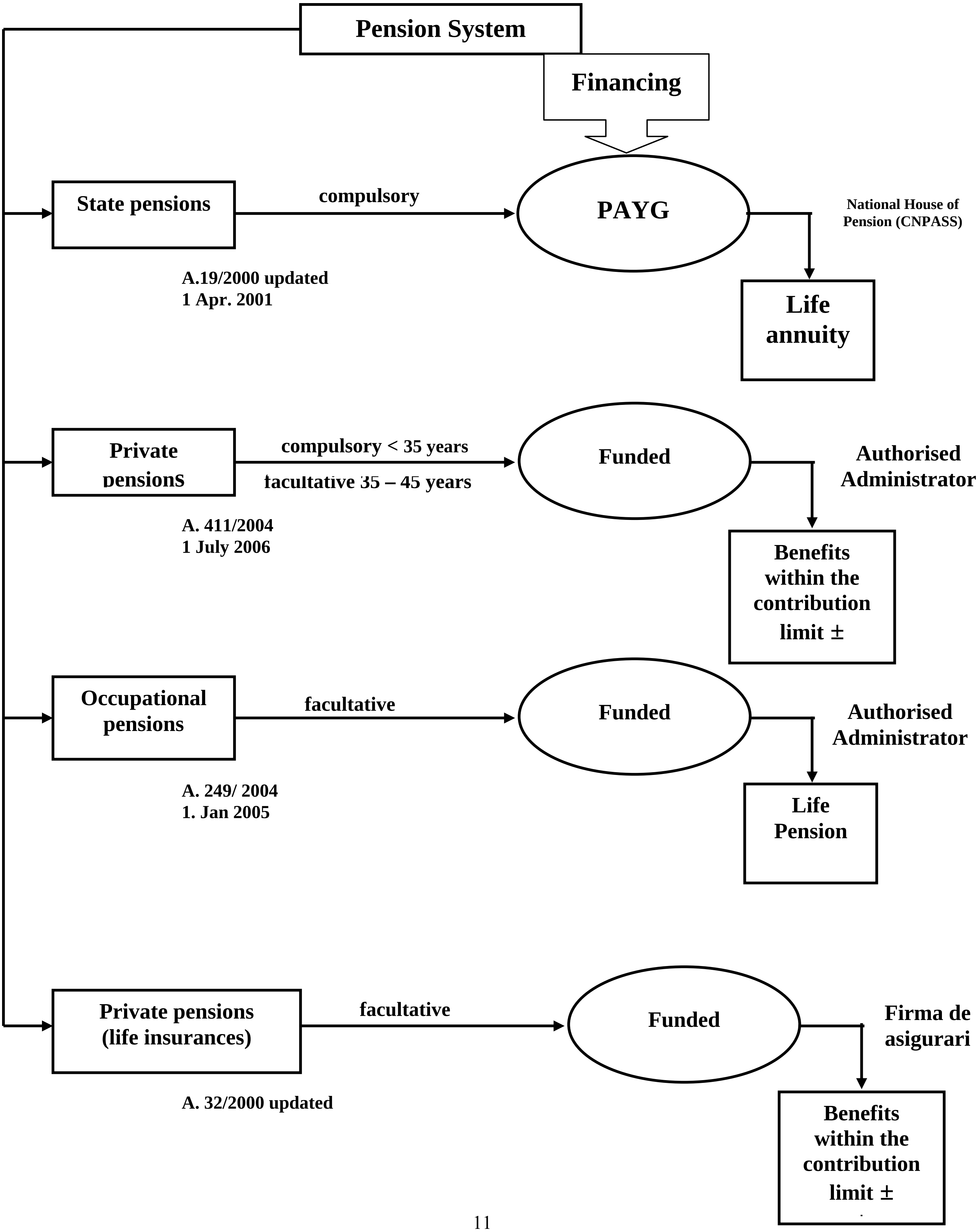
Pension in the new system is considered an employee's right and not a duty. An employee may remain active for an unlimited period, after fulfilling the retirement age, with employer approval.

The **advantages** of the designed system, comparatively to the possibilities of pension insurance in 2000 were mainly as follows:

- *the area of potential contributors to the system increases*, future pensioners being able to forecast to a larger extent the level of the total pension or benefits (fixed amounts, time-limited annuities, life annuities) on the retirement age;
- *The calculation algorithm of state pension allows for a direct connection* between the contribution history and benefits by means of the average individual score.
- *the mix insurance* allows for building up the components of total pension depending on the particularities of the situation for each individual – age, professional level and performances, the amount of total incomes, etc.;
- there is the *possibility of additional insurance by means of pillar 1* (up to the limit of 5 average wages), eliminating thus the risks in the activity of market operators (at least until the consolidation of the old age insurance market);
- *A greater transparency* of the system is assured, especially due to its private component, the members of the private funds or the participants to occupational schemes being able to follow the activity of the operators.

Scheme 1 **Overall scheme of the applied pension system**

(Situation at the beginning of 2005)



As already stipulated earlier, some characteristics of the pension system are determined by the particular circumstances from Romania, i.e.:

- **Occupational pensions have a narrower sphere of application and they are optional.** The participation to an occupational scheme is negotiated with the employer. The employment of one person or gaining trade union membership cannot be conditioned by the participation to an occupational scheme.
- **Private funds are initially constituted by the transfer of a part from the contributions to the public fund** (2% as of January 2008), after which the contribution is increased gradually up to 6% and it is **compulsory only for the newly entered persons into the system (under 35 years)**. The transfer to private funds is estimated to 24 millions Euros in the first year of application. The switch to a private pension system, next to the improvement of collection in the public system by including the workers from abroad, prohibition of instalments and enforcement of bad debtors represent the most probable measures that might avoid pension system bankruptcy according to its current build[7].
- It was aimed to direct funds' investments to prudential **portfolios**. By law there are provided investment types - in general, those transactioned or quoted on supervised markets and which are stipulated in the Supervision Commission Norms. By this selection, **investment risks are limited and a more proper estimation can be made about expected incomes.**

Organisation and functioning of the pillars is based on a sum of common principles (Annex 3) that have in view the **equality in treatment and the solidarity** – in the participation as shareholder/contributor/beneficiary, and information about efficiency.

The amounts originating from contributions to the private funds are invested with the purpose of maximising incomes and in the exclusive interest of the beneficiaries, in compliance with the following principles:

- Prudential management and insuring the assets safety

-diversification of investments and risk management; investments quality and profitability

- maintaining an adequate level of solvency and liquidity

By means of the new system it was aimed to create opportunities of obtaining higher total pensions through participation to several pillars. The risk is diversified and prudential investment restrictions of the capitals ensure an increased predictability of the total pension quota.

3.2. Inconsistency and subjectivism in implementation. Pensions levelling

At declarative level, a swift and full implementation of the system was intended, initially even with several pillars at the same time. In fact, even nowadays the system is not entirely functional. The law of the public pension system waited in Parliament to be discussed and approved from September 1998 to September 1999, and thereafter yet two other months to obtain the endorsement of the Constitutional Court (for some of the provisions). In its turn, the regulation regarding universal pension funds[8] was withdrawn for adjustments/improvements few days after its approval by the Government (after 3 years of work for improvements, the law

[7] Source: Revista Capital, 19 August 2004.

[8] For more details, see Gh Zaman, V Vasile (2001) –Intergenerational problems in Romania with a special view on pension system reform, Discussion Paper no.20/2001, IER, Hitotsubashi University, Japan

was given up altogether). Practically, the reform started just with the implementation of pillar I (a year after approval). Finally, after prolonged discussions with trade unions, it was agreed on the idea of introducing occupational pension schemes, completed with private funds, regulated by specific laws in 2004.

Indeed, the reform of the system in its assembly either is delayed as against the initial programme, or, and this is far more important, **is unduly postponed comparatively to the practical needs of present and future pensioners.** Even in conditions of focusing practical efforts just on the reform of public pensions, *the adjustment of system lacks* was postponed/corrected repeatedly and *substituted rather* with *conjectural alterations* instead of *conception or development* ones (recorrelation instead of recalculation, for instance). Moreover, after 4 years since the first attempt of introducing private pensions, **the conditions are not given** for their implementation. The population is poorly informed, existing market operators are not attracted to the proposed system argumenting that it lacks incentives and is inefficient.

Box 1 **The insurers criticize the private pension acts – main issues: number of participants and lack of functionality**

The main issue refers to the **limited number of participants**

- For occupational schemes the insurers appreciate that under the conditions in which only employees have the right to contribute (not also self employed) and only those from companies without debts to the state budgets, the market potential is very low, respectively 450 thousands contributors in the first year;
- For private funds, limiting the compulsiveness of participation determines the entering into the system of about 100 thousands individuals per year.

Large companies consider that approved acts determine non-functioning systems, because:

- The number of contributors and the maximum level of provisions are limited, so that administrative costs cannot be covered
- Proposed contributions are diminished and inconsistent, stimulating pensions for participation cannot be accumulated
- A level is created on the insurance market for small and unstable companies, which could generate in the future lack of credibility for private pension funds

Source: Simulation of private pensions; www.9am.ro

Additionally, the economic climate does not prove itself as “favourable” to sustained efforts for pensions’ reform (a recent example: on request of IMF, in order to rebalance the general budget after introducing the flat tax rate of 16%, the entering into pay of recalculated pensions shall be done only partially, that is in 2005 for about 1.5 million persons).

3.2.1. Recorrelation

If for the new pensioners the enforcement of Act 19/2000 meant their participation to a reformed system, for the persons already in the system it meant only a sharpening of inequities. For the first time it was provided that the recalculation of pensions should be realised in May – December 2000 and to include persons pensioned until 1997[9]. Although it was considered at the respective date that pension increases should not be very significant, it was aimed that pensions become equal “for equal positions and equal periods of contribution”. Practically, a review of the dossiers was not realised by applying the same calculation formulae as for the new pensioners, **but an adjustment of the score depending on the year of retirement**. This process was changed thus into recorrelation. **Recorrelation** did not represent a novelty, this

[9] Those pensioned after 1997 did not enter into recalculation because their pensions were higher than the net wage they had before retirement (Source: Smaranda Dobrescu, Labor and Social Protection Minister at the time http://adevărul.kappa.ro/eco418-03.html)

technique of re-establishing some balances between the pensions' level being applied also in 1995 (GO/848) [10].

In 2001, after a month since the enforcement of state social insurance pensions' act, the **procedure of pensions' recorrelation** is instituted, **that consists in increasing pensions by differentiated per cents, depending on the pension category on the recorrelation date and on the year of enrolment for pension**. It was foreseen that the process shall be realised in 6 stages until October including only pensions that exceeded the value of an average gross wage on economy and that entered into pay before 1998. Higher raises (of up to 53%) were provided for the older pensioners that fulfilled the conditions of full stage of contribution and age limit.

In the period **2002-2004** the pensions for age limit with complete length of service entered into pay until 1 January 1999 were subjected to some **additional measures of** semesterial **recorrelation**. It was applied for persons having a corrected average annual score smaller than the minimum ceiling approved for participation to the system (3 points). For each stage of recorrelation was determined **an additional number of points differentiated after the year of enrolment for pension, which was added for pensioners scores in the same category of pension, enlisted in the same year.** As reference element in calculation was taken into account the estimated average score for a person retired on April 1st 2001, e.g. one for whom the provisions of Act 19 were applicable. In this manner it was aimed to bring the level of pensions in payment before 2001 nearer to the one following April 1, under comparable conditions of contribution history, all calculations being made at average level.

From the additional recorrelation benefited also farmer pensioners, but the granted extra score was somewhat more reduced.

The total number of points granted in the two years of supplementary recorrelation was of up to 0.3 points, again the most senior pensioners receiving the highest score increases. The quantum of recorrelated pensions was determined by multiplying the adjusted score with the value of a point of pension set out annually by the budget of state social insurance.

The entire process of recorrelation represented an increase of the smallest pensions towards the average level, the final purpose being to ensure supplementary social protection by means of the pensions' level **for the most poor and senior pensioners**.

Pension increases were not significant. For instance, a pensioner in pay from 1968, or before, benefited due to recorrelation of a pension increase of 48.38% in May 2000 (but not more than the average pension at the respective moment), to which was added in the period 2002 – 2004 an increase of maximum 0.3 points (about 2/3 from the value of the previously granted raise).

The obtained effects did not justify the administrative costs involved because this action did not solve the issue of reinstating some sort of balances but aggravated imbalances, the fundamental solution being just postponed.

3.2.2. Differentiated indexation

Parallel to the recorrelation, in order to protect the buying power of the pensions, a periodical (quarterly) system of indexation was applied. In the 14 stages of indexation undertaken since the enforcement of Act 19 and up to the end of 2004, the nominal pension increased with more than 2/3, the per cents varying between 7% in December 2001 and 2% in March and June 2004. The pressures exercised to maintain the state pension at a satisfactory level that could

[10] An equivalent quantum with the individual pension from 31 October 1990 was determined, which was multiplied with the index 88 that expressed the increase of the average state social insurance pension in the period Nov. 1990 – Sept. 1996. If the pension calculated accordingly was smaller than the one in payment, the latter was maintained.

attenuate/annul the effects of inflation were rendered practical in the differentiated indexation, the most reduced increasing swifter.

The indexation targeted the increase of the pension's point value and of this measure benefited just persons with a pension smaller/equal to the value equivalent of the maximum approved score. Pensions exceeding this ceiling were indexed with 1 – 2%/stage. These indexations were under the IPC level, thus the purchasing power was gradually diminished, more marked for those with higher pensions.

Also in this way the **concentration process of the pensioners at the basis of the distribution scale on pensions' levels was weighty**. **Very low and small pensions tend to become equal**, without any consideration for the personal contribution effort.

3.2.3. Minimum economic effects, major social implications

The two processes developed in parallel (recalculation and indexation) have created **confusion and dissatisfaction** among the beneficiaries. They had as **social aim** the **attenuation/diminishment** of poverty for this population category by supporting a more significant increase of smaller pensions. But, the indexations covered only partially the real inflation rate, and the recalculations did not trigger significant pension increases (Annex 4). The final result was of ***concentrating more and more pensioners in two areas***:

- ***The one of smaller pensions than the average level*** achieved by "raising the base". It was mainly the result of recorrelation;
- ***Near the inferior limit of the maximum contribution ceiling*** (3, respectively 5 pension points * value of the point) but it is a still rarefied area as compared with the aforementioned one.

The financial effort, not at all negligible, has unbalanced even more the system, but without solving the issues for which it was initiated. The pensioners continued to get poorer, over 50% from the persons in a pensioner household have incomes placed in the first 5 deciles, respectively under the national minimum gross wage[11] (Annex 5) inducing problems also in other social sub-systems:

– health care, due to insufficient funds for medical assistance;
– Many persons asked more frequently for social assistance services. At present a significant part of pensioners cannot pay from pension even the household maintaining services during winter;
– More marked isolation, social exclusion, the emergence of psychical problems, etc.

If in 2000 the incomes from social protection provision represented 38.2% from total monetary incomes of pensioner households, in 2002 these increase to 42.3%. Their plentiness may be judged by means of associating incomes from pensions with the ones from wages the weight of which also increases from 11.6% to 18.1%.

Discontent has increased and many pensioners have become dependent on the younger family members. Only few of them, in order to add to their incomes re-entered the labour market, preponderantly the parallel one. Why not in the real economy? a) The wage revenues is associated with all social contribution burden and the employers were not ready to pay it – the fiscal burden of the employer in 2004 was of minimum 37.3% from the gross wage, and the one of the employee 28.9%; b) immediate cash incomes are preferred instead of other, future

[11] In the first quarter of 2002, the gross minimum wage was of 1.400.000 ROL/month, and the minimum consumption cost per person was of 1.632.770 ROL (87.5% covering degree).

advantages (after each additionally worked year, the pension could be recalculated, meaning an increase, but the amount was a lot smaller comparatively to amounts cashed "in hand" as result of delivered work). Next to it, the dynamics of economic restructuring and the growing degree of employer's adjustment to the exigencies of a competitive market (product quality and economic efficiency) **restrict the re-insertion and/or remaining on the labour market for a longer period of third-age individuals if these cannot update their knowledge and/or maintain the individual performance in their work**. CVT costs and support programmes on labour market of elderly employees (promoted by NAE) are few and with weak efficiency.

As a rule, the persons over 50 years who did not benefit of high professional training or a good labour performance become long-term unemployed or low paid employees. Many chose early retirement if they fulfilled the conditions, even if they received a partial anticipated pension. The chances of a pensioner to return in advantageous conditions on the (real) labour market are limited and therefore formulas are preferred of the type pension + incomes from the parallel market. This solution has severe implications at economic level, in the business environment the "games" being distorted by the (significant) activity of the parallel market, with all complementary implications. In family, pensioners, and especially the older ones turn into a real burden mainly for the households with small, under average, incomes.

3.3 Chronic system crisis. Perenity of inequities

Reforms should result in sustainable solutions to the long term problems and not just in stop-gap responses to imminent problems (COM (2000) 622 final).

More and more profound inequities, incomes from pensions much smaller comparatively to the necessities for decent living have triggered/forced essential/fundamental decisions, such as of the type ***pension recalculation and continuing the reform with private funded pensions***.

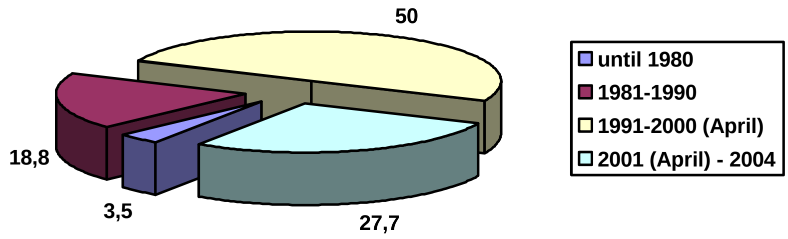
3.3.1 Some basic "correction/adjustment" measures of the pillar I

After 4 years of trying to avoid **pension recalculation** by means of partial adjustment measures (recorrelations), finally this process has been started up in October 2004. It was agreed that recalculation should be realised based on the algorithm provided in Act 19 in order to determine the average score for all those present within the system. It is a new attempt to implement/apply the principle of equity in setting out the pensions within the whole state pension system -"under equal conditions of pensioning, equal pensions, irrespective of the retirement year". So, by the end all pensioners should know their score/number of points that shall be maintained for the entire period of paying the pension. It shall be annually evaluated and changed into pension based on the corresponding value of the pension point as provided by the Act of the state social insurance budget.

The quantum of the pension resulted from calculation will not be applied this time, either. This shall be compared to the level of the pension in pay and as pension shall be granted the highest quantum. If the pension in pay exceeds the pension in calculation, then the one in pay from which the pensioner benefits shall remain in pay and unaltered until the date at which, by applying the calculation formula provided by Act 19/2000 a quantum of the pension shall be obtained which is higher than the one above. By the GEO/3.02.2005 it was aimed to speed up the process - shall be finalised in 2005, but the increased pension shall enter into pay (where necessary) in instalments until 2006.

From this measure will benefit 4.2 million persons retired before 2001, the first beneficiaries being the oldest in the system.

Graph 2 **Pensioners in payment within the social security system after the date of entering the system (*)**



(*) against the number of pensioners in November 2004* = 6.050.097
Source: CNPASS data

From this recalculation will benefit about 70% of all pensioners in pay, but only a part of them shall receive increased pensions, after the first estimates, about a half[12]. The recalculated rights shall enter into pay as of March 2005. So, in a first stage, the oldest pensioners of the system (214.000 persons), shall receive increased pensions depending on their individual situation (pensioning dossier). After recent estimates, the system will have a 12-17% overall increase of the funds, with different sums per pensioner, the possible increases being even of several millions Lei/month.

The estimated effort of the social insurance budget shall be for 2005 of 7054 billions Lei, the additional expenditures of administration and logistic services being yet other 500 billions Lei. The recalculation, a measure that was somewhat necessary, implies in reality a lot of higher costs if we consider also the losses resulting from the inefficiency of alternative measures from the postponement period. It might also be argued that the financial effort of now as well is somewhat smaller precisely due to former recorrelations, but if we compute the total administrative costs we find an inefficient management of budget's resources.

3.3.2. Perenity of system's inequities. A vicious circle

Recalculation, per assembly, **does not solve the coherence issues of the system and of promoting intra- and intergeneration equity in the redistributive system**, at least for the following reasons:

- The extent to which it is applied *only by increase* – pensioners who from recalculation have obtained a more diminished pension than the one in pay shall remain with the pension (in pay) frozen until the system is raised to this level. It results that for a certain period they shall maintain the advantage.
- Those who have obtained higher pensions, mainly unduly, but legally determined at the respective moment remain the system's favourites (for a limited period or during the entire life[13]).

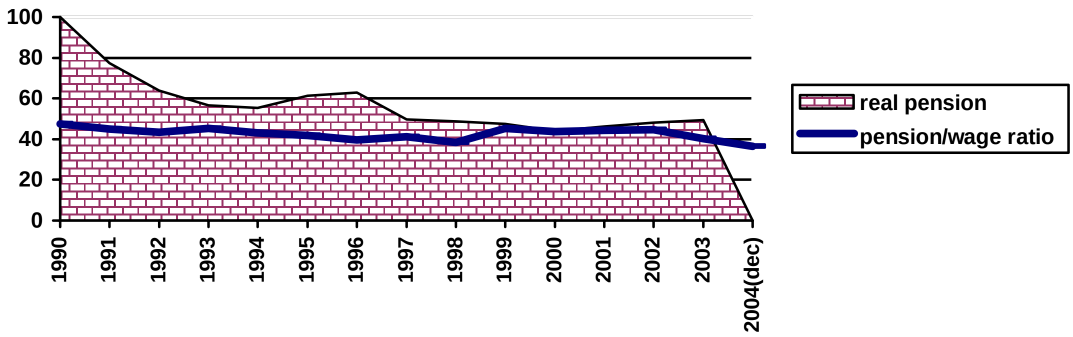
[12] CNPASS has announced that from the 285.000 dossiers already analysed from the beginning of October 2004, in 55% of these the score obtained was higher than the one in pay, the pension increase being comprised between 1.750 and 3.962.600 Lei. Only for 6.5% of the evaluated dossiers additional documents were necessary (labour cards, certificates with bonuses, etc.). The first dossier entered into recalculation was the one of Elena Mungoci, from Arges, aged 109 years. As result of analysing the dossier, the old woman received additionally almost 342.000 Lei (less than 10 Euros/month).

[13] At present, within the system there are about 20 persons with pensions around 100 millions Lei/month (2700 – 3000 Euros/month). For these, the pension level shall remain frozen probably for the entire period of its payment.

- The recorrelation effects are eliminated but *the inequities* regarding the wages policy *promoted during the communist period and in the first 10 years after 1990 return into actuality*. The history of individual contribution depends on the wage level and the contribution period, and not the occupation and the professional training level (for instance an electrician might benefit of a higher pension than a physician, a turner than an university professor, etc.). Moreover, the dispersion of salary incomes and of other benefits within the same professional category, without precedent especially after 1990, continues to increase/expand.
- Differences and implicitly *inequities* are maintained between pensions in pay of persons who worked *in sectors that have their own pension system* within the state system (military, magistrates, etc.) as against to those from the system regulated by act 19/2000[14].
- If we take into account the construction of the PAYG system, under its current form, the new pensioners shall receive pensions including *inequities determined by the computation methodology itself of determining the pension level* – either the value of the pension point, or the contribution history which is limited.
- The weak efficiency of the system induces the adjustment behaviour on short-term. *The presence of pensioners on the parallel market* for supplementary incomes will increase.

Out of this financial and human effort **the gain is more at the image level for the reform, and much less of a practical nature**. In addition, all pensioners in 2005 shall be affected by a new decrease of pensions' purchasing power. The 2005 value of the pension point has included also the effects of the expected inflation. But the implementation of the flat tax rate, for instance, generated a chain of price increases in other fields (recommended by IMF during the meeting from Bucharest in February). But, the last estimated prices increase for household services shall exceed total prognosed inflation for this year of 7%.

Graph 3 **Pension/wage ratio and real pension, 1990-2004**



Source: based on NIS data

[14] Recalculation of state military pensions is regulated by Act 164/2001, Act 479/2003, GD 69/2004 and is applied to military staff of public institutions of national defence, public order and national safety, as well as to the **civil staff** from these institutions (from the professional viewpoint they might be compared to the one of the other industries).

4. A sustainable pension system, or just a new challenge?
Expectations vs. practical possibilities

4. 1. Access to the state pension system of young generation

The studies performed by experts underlined that *"Romanian employees shall work more for lesser pensions"* [15].

The system of compulsory pensions, applicable to persons who are currently under 35 years is subjected to the following **constraints**:

- *Financing sources of pillar I are getting cut short*, the narrowing of the labour market and also of the contributors´ number inducing additional fiscal burdens and the danger of recording repeated, higher and higher fund deficits. Paradoxically, in Romania employment falls down, the number of employees' decreases, but in parallel a constant unemployment rate reduction is registered (7.8% in Dec2003, 6.8% in Dec2004). Thus, the number of contributors compelled to participate to the system is diminished and the voluntary insurance compensate but partially this "deficit".

- even though participation to *private funds* shall be compulsory for the young labour force, no significant sums are transferred for this fund from pillar I, next to the fact that the PAYG system shall become deeply financially imbalanced. A monthly contribution of about 8% for an average low wage (about 300 Euros/month) even if obtaining a high efficiency of the fund, *it cannot assure any decent "comfort" by far* for the future pensioners.

- In accordance with Act 19/2000, a young individual of 35 years shall have to work 5 years more than his parents and shall receive a comparatively lower pension.

Facultative funded pension, even recognized as necessary is far less probable to develop significantly in the next period. Main reasons are:

- *The system of occupational schemes does not seem attractive*. Additionally, the 200 Euros/year deduction from personal incomes taxation for participating to the system could not be consider as an incentive because it assures a very small (completion) pension (a simple calculation shows us that under the conditions of a contribution within the limits of deductible sums until the fulfilment of the legal retirement age, the obtained additional pension is of 80 Euros/month for a person up to 35 years, 35 Euros/month for a person up to 45 years and of about 11 Euros if the age of entering into the occupational scheme is of 55 years). If we consider a decent additional pension of approximately 400 Euros per year, a beneficiary of 35 years should contribute about 800 Euros/year for 30 years, one of 45 years with 1800 Euros in 20 years, amounts that cannot be directed to these destinations just from work incomes!)

- *participation to life insurances of the pension type* addresses itself practically to a small part of population, the market for these types of insurances knowing its own developments are just loosely related to what happens within the old age insurance system.

Pensioners of tomorrow remain, just as the ones of today, among the poorest Romanians (for at least yet another century quarter):

a) Pillar I even if operational for 4 years under the present construction **has not delivered yet the expected results** and serious "self-financing" problems are expected.

b) Funded pensions, even already regulated are still not operational. No occupational scheme has been established (the estimate participation is 100 thousands/year), and the private funds

[15] Revista *Capital* 19 august 2004.

shall be compulsory only for about 600 thousand persons in the first year, fact that diminished the interest of large insurance companies about the new market.

4.2. Economic – social and demographic conditions – restrictions in applying the pensions' reform

For a certain period of time, it was attempted to justify the inefficiency of the pension support and reform policy by the "inheritance" of severe inequities from the old system promoted by the communist regime. After 10 years of correction, adjustment, revigoration and preparation endeavours for switching to a modern system, based on several pillars, and after 4 years of (truncated) enforcement of the PAYG scheme in his new architecture we have reached the **point of a new beginning (year 2005)**, when the intentions aim to resolve the ground issues – *"reinstaurating equity within the system and its efficient operation" – and, finally, supplementing the system with occupational schemes and private funds.*

Comparing the "initial" moments from 1990 and 2001, **in 2005 the economic-social conditions are, in our opinion, far worse because**:

a) '***The external environment' does not sustain pension system reform,*** revigoration and far more important its efficiency:

- The economic dependency ratio continues to deteriorate, currently an employee supporting 1.4 pensioners. From 1990 up to present through economic restructuring more than 4 million jobs were lost and the number of pensioners has increased to over 2 millions.
- The economic performances are still fragile, the economic 'support basis' for PAYG is insufficient (small wages, evasion, etc.). Although in the last 4 years GDP increased with about 5.5% per year, the average wage remains low – around 195 Euros/month in 2004 and the underground economy represent about 25% from employment; in accordance with the Updated Economic Programme of EU-preaccession, the growth pace of the actual wage shall be diminished, which means also reduced contributions for social funds, but also a decreased propensity for participation to funded pensions;
- The part-time and temporary employment gains more ground, and the proposals of altering the Labour Code (reintroduction of civil contracts, for which in the past no contribution was paid towards pension) shall narrow even more the sphere of potential contributors;
- Fiscal reform contributes much too less at stimulating the participation to the system, especially in the case of private pensions; for instance, the contribution to the pension system is deductible just for pillar I integrally and on a certain sum for occupational pensions, and probably within the limits of the compulsory contribution to private funds;
- The transfer rate and maximum contribution limit to PAYG assures far too modest benefits as against the necessities of decent living standard at old age. The net average pension for age limit and complete contribution stage in Dec2004 represented 51% from the monthly nominal net salary earning; the pension point value of 39% from the estimated average wage in 2004 decreases to 32% in 2005.
- The indulgent attitude or of non-involvement against the improper enforcement of legislation regarding contributions' collection (sanctions for companies or institutions are applied either selectively or not at all, and exemptions or

postponements have diminished significantly the incomes of the state social security budget).

In addition, the **restrictions** should not be omitted which have become **pereneous** for the pension system reform in Romania (and not only) (V.Vasile 2001, 2004):

- *Demographic ageing* – fertility rate and life expectancy at birth. Romania cannot ensure generation replacement and the average life expectancy (among the lowest in Europe) is on slight increase;
- *Young generation postpones entering on the real labour market* due to extending the initial education period and/or to activities developed on the parallel labour market, so that the total contribution period is more reduced;
- *'The dual' payment system of labour*, by declaring wages at the minimum level, especially in the private sector of the economy, and paying the remaining 'negotiated income level' in cash, with no social contribution; it determines a reduced volume of contributions to the pensions fund;
- *Weak attractivity of the pension system for those who are active but do not have the employee status* (who can conclude facultative insurance contracts in PAYG), mainly due to the reduced efficiency of the system, estimated benefits being regarded as too small;
- *The effective average age of retirement*, at present around 52 years is relatively *reduced*. Its increase particularly based on the diminishment of the numbers of anticipated retirement and of sickness pensions for the 3rd degree of invalidity shall lead to an extension of the contribution period within the system;
- As a complementary factor, but very important – *the health state of the population* measured by infant and general mortality, but also by the health state on age groups. It is also necessary to consider the health care system estimate efficiency - which nowadays does not ensure adequate curative and even less preventive assistance;
- *Increasing the attractiveness for the domestic labour market* for the young generation (in order to enter/return) far better trained professionally (but also with other expectations) and for those who temporary migrated to work abroad (and return with another labour culture);
- *Globalisation of labour markets and participating to the single EU market* (could) determine the decrease participation rate to the national pension system of the origin country. Labour force[16] migration and the perspective to become member-state of EU open the opportunity of choosing the most attractive pensions schemes from EU countries. Additionally, the increasing emigration of young persons stresses the structural ageing of population.

b) – ***a sum of deficiencies is manifest in the pension system:***

* **Constructive, financing, etc.**

Insufficient sources for financing pillar I, and even less for the determined transfers to private pensions;

Erosion of benefits from pensions due to the continuous inflation, increasing the proportions of poverty among old age persons

Inequities within the system are still maintained

[16] For details, see PAIS II, Study No. 5, IER, 2004, Bucharest

lack of attractiveness for participating to the system for future beneficiaries, as well as for market operators, the attractiveness rate of the system and the efficiency rate of benefits being “non-incentivising” (including, or maybe especially for private funded pensions).

*** Of image and transparency:**

Weak information of potential contributors about the advantages of the proposed/implemented system

Transparency lack in underscoring (properly and completely) the results/effects of the reform measures.

4.3. Third age welfare of present contributors to the system. Intergeneration solidarity versus personal responsibility

4.3.1 Is the future social security system of elderly in Romania able to ensure “old age safety”?

As target and major challenge for the architects of the pension system, the functioning and especially the social efficiency are hard to achieve. There is, and (at least) on average term there shall be maintained a range of ***factors – restrictions the impact of which cannot be attenuated/cancelled only by adjustments of the social protection system at old age, but by complementary measures and policies on the labour market, on the educational market, in the system of elderly assistance, of health care and of demographic policy, etc.***

Among the most significant factors for Romania, we remind:

- **Economic growth** – real and sustainable based on promoting competence, performance and competitiveness;

- attracting and maintaining on **labour market** a qualified and (financially and professionally) motivated labour force. Free movement of labour and developed countries policies to cover own deficits of human resources with immigrants[17] remain a factor of diminishing the labour force supply on the national labour market.

- The need to be also employed for **the elderly population** increases considerably, but efficiency remains low. In Romania the elderly population is forced to add to pension incomes by temporary (re)employment[18]. With only few exceptions, the jobs (usually part-time) for them are under their professional training level or work experiences and incomes are more reduced. There is also the possibility of continuing the activity after retirement age, even if the contribution stage is complete, or higher, but of this facility may benefit just some categories of employees (with high professional training, or with expertise that is lacking on the labour market) and just if the employer agrees to it.

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[17] Even if the Lisbon target of 70% employment is achieved by 2010 and maintained thereafter (which is less probable – author’s note), the Commission predicted that the number of employed people within the EU will actually fall by 20 million between 2010 and 2030. The prospects for economic growth – the result of the combined impact of employment and productivity growth – are worrying. While no one suggests that immigration provides the complete solution, sustained flows of labour migration are needed to compensate for an ageing population. Several Member States have re-opened channels for economic migration and economists highlight the role immigrants can play in matching labour demand and supply. (Managing migration in a global economy. Migrants can contribute to meet Europe’s challenges, Social Agenda, the European Commission’s magazine on employment and social affairs, issue no. 10, December 2004, p. 18).

[18] Legal regulation allows that pensioners develop activities and receive wages – save for those retired on health grounds or who are under the legal retirement age and benefit of anticipated pension.

Box 2	Self-supporting capacity of the pension system

Pension system self-financing is difficult to be balanced without transfers from state budget, among others, because:

- -The 15 years and over employment rate is reduced, 51% in 2003 and decreasing;
- -The employees share in total employment remains low, 62% in 2003;
- -Labour incomes cannot sustain a decent living standard. It remains modest, much lower than in other CEEC countries, and revised PEP stipulate a slowdown increasing trend of wages in 2006-2007;
- -Old age employment rate (55-64 years) was 38.1% in 2003 and the one of the 65 years and over represented around 18%.

All these lower performances (in comparison with the Lisbon Agenda) with a significant impact on pension system financing request a deeply (re)consideration of the pension system sustainability and perspectives.
Source: AMIGO Survey

4.3.2. New adjustments are necessary

Demographic evolutions, population mobility and financial problems of the political system determine *a permanent reform of the old age insurance system*.

An active person developing activities in various geographical spaces has as principle the right to be insured, using in the case of pensions the scheme which seems best suited to the personal situation. This implies for the Romanian pension system as a whole a rethinking of its architecture so as to become **attractive for future beneficiaries, and at the same time be able to support current pensioners** who are entitled to such benefits. A special attention is necessary for pillar I constructive scheme. It is simultaneously an issue for the calculation algorithm and participation conditions, but also a financing one, mainly in the case of temporary imbalance which at present is insured by the state budget or other funds collected through other channels also from the population.

Box 3	Intergenerational solidarity – another approach

The intergenerational “contract” of redistribution was rationalised by granting benefits depending on the contributions paid during the entire active life.
The intergenerational solidarity is debated on moral and reasoning grounds.
The social policy is opposed to the economic competitiveness exigencies and the **first** “casualty”... is the public pension system, due to the high level of compulsory social contributions. Employers’ associations explain the volume of the black labour market as due to these excessive social contributions.
Source: E. Dumitru, Sistemul de pensii în România, încotro? [Romanian Pension System, Whereto ?], The Society for social-democratic debates, Foundation Friedrich Ebert, 17.02.2005, Bucharest

Another aspect that should not be ignored is represented by the presence of active population (only or in parallel) on the informal economy, mainly due to the favourable economic environment. Usually, these persons do not participate in any way (or only at minimum limit) to the pension system. These won’t have incomes such as pensions on retirement age, or their pensions will be insufficient. The social burden shall be transferred on the social assistance system which is unlikely to be sufficiently consolidated in Romania as to solve such problems, as well. The question arises, under these circumstances, whether **special measures are not necessary for those who today**, for various reasons **do not participate to pension system** to such an extent as to have insured a minimum replacement income required for a decent living in the 21st century. ***The current legal regulations seem to knowingly omit such situations that won’t disappear, but right on the contrary shall amplify.***

Irrespective how many estimates we would do, the picture of benefits at the retirement age of today’s young people has a single positive variable and a number of restrictions:

- **Significant participation to the system is the only chance** for being able to anticipate a **decent pension** at old age. This means pillar I (compulsory by law for employees) and in addition, and mainly, contributions to the private funds;
- **the participation restrictions are multiple**, among the most important now, and for a significant period in the future there must be considered:
  a) incomes remain relatively low in a society in which prices are (shall be until 2007) comparable to those in developed European states having labour incomes several times higher;
  b) insurances for work delivered abroad represent more something desirable than a reality;
  c) Even if the participation to funded pillars is desired, the shorter contribution period and/or relatively low possible contributions determine a diminished efficiency of personal accounts.

Not long time ago a Romanian saying "who does not have grandparents/elders should buy some" could be understood also under the form of support, including the financial one, ensured by the elderly from their pension, for young families. **Currently, more and more old persons are financially supported by the younger members of the family** because their pension is not even enough to pay minimum services for household. The promised recalculation does not solve the issue of financial independence of old persons with small pensions, and the state is incapable to ensure the specific social assistance required for third age persons. In addition, charity actions and the NGOs activity is (still) at the beginning and covers only partially and insufficiently the needs of elderly. ***The current situation of pensioners might be regarded as similar as or even far better than the one of future pensioners, who are today's contributors.***

The spectre of poverty in old age for those active today, starting from the current structure of the pension system (even under its revised form and completed with private funds) seems as **inevitable**. The prevention of such a situation implies, next to the contribution, also capitalised funds and the long-term re-balances of pillar I (including the development of a PAYG system subcomponent that should allow a minimum pension to cover the basic needs of the population). *If we take into account the minimum insurance ceiling provided* by Act 19/2000 it may be considered that the legislation envisaged such a situation but the quota of ¼ from the average wage (3/4 from the national minimum wage) *is merely symbolic, the resulting pension being insufficient even for covering the absolute poverty line (!)*

5. A coherent strategy of old age insurance

The social security systems remain important for the Romanian society of today and tomorrow. At their core shall be placed the pension insurance. **If for today's pensioners the redistributive system remains the single solution, for future pensioners a single viable direction may be outlined, the orientation towards a combined pension, in which the contributively component determined by personal responsibility shall be predominant.**

5.1. Towards an efficient pension system. Requirements for a sustainable strategy

Starting from Romania's firm orientation towards accession and considering the targets established for the field at EU level in Lisbon (2000), Santa Maria da Feira, etc., the reform measures naturally nuanced in accordance with the domestic specific must be subordinated to the general goal of **long-term sustainability of the system**, meaning ***their ability to meet***

social objectives on an ongoing basis while maintaining other important policy goals, such as sound public finances and intergenerational equity.

This means, at the same time:

* High rates of economic growth and macroeconomic policies that should support social reforms;

* increasing employment and retaining/keeping the young people on the domestic labour market (provision on better employment incentives), as support for extending the contributors basis to the PAYG system;

* increasing labour productivity; an integrated policy of technology driven productivity growth, better jobs and greater social cohesion;

* ensuring the gain of incomes from labour that would allow for the participation to private insurance systems and to occupational schemes;

A coherent and adequate strategy must be based as well on *intra- and intergenerational consensus, on involvement and commitment of relevant stakeholders* as on *ensuring confidence and broad acceptance* of the system reform.

In Romania a series of adjustments are necessary, focused on:

- *Stimulating participation* as well to the public system as to the private funded pillars;
- *Rebuilding pillar I* for assuring the viability of the system in the future. On one hand this is about introducing elements as funded schemes, and on the other, about "cleaning" the system of non-contributively services;
- A control of administrative expenditures, *increasing the efficiency of funds management*; diminishing fiscal evasion;
- *Avoid the premature exit of the older workers from the labour market* by providing stronger employment opportunities for them and restricting early retirement
- *Introducing without further delays private funded systems and stimulating participation*, inclusively by higher/total fiscal deductions;
- *Strengthen public confidence* in the pension system and diminishing the differences against similar systems from other countries in order to limit transfers over the border[19].
- Periodically, depending on the demographic situation and of the labour market it is necessary *to modernise/adjust the pension system and labour market policies so as to be mutually supportive* and more conducive to the promotion of economic growth and social cohesion.

Box 4 A priority of the present Government (Tariceanu, of democrat-liberal orientation) - improving the life standard for elderly

Main objectives of the reform:
-financial enhancement of the public pension system and ensuring adequate incomes for pensioners within the system;
-reconstruction of pillar I by "cleaning" it, among other measures, of some types of non-contributively services[20];
- Introducing new financing and administration alternatives for pensions of the funded – type, private management, which should ensure for future pensioners not only a certain income, but also a decent one.
Source: GD 24/2004, Governance Programme

[19] For Romania it represents currently only a potential factor but one that can be avoided/limited by the reconstruction of the system in itself. But just as true is that we might face delocation issues of some economic activities just because of the relation taxes/contributions and other public services in the public field (first of all, it is about the wage taxation, respectively the social burden, and secondly about the services efficiency).

5.2. Partnership in building and sustaining an efficient insurance system for old age

The modernisation/reform of the pension system by its nature is a more and more complex process that implies **various interests and actors.** The life conditions of an increasingly larger part of the country's population depend on the cooperation and convergence of their actions. It should not be forgotten that **for each generation of beneficiaries (pensioners) or of contributors (employees) the (legitimate) expectancies must be respected and an equitable balance maintained between rights and duties.**

In addition, any reform and even more so a reform in the social field must sustain/transpose into practice the core objective of achieving **its role as collective guarantees against poverty and social exclusion, based on commitment and political will. Much needs to be done to involve the social partners, NGOs, local governments, community groups and individual citizens.**[21]

Partnership presupposes assuming responsibilities by all interested social actors for:

-promoting affordable, high quality services, in particular for long term health care

-ensuring equal opportunity regarding access to services, including through innovative funding.

6. Brief conclusive considerations

Financial independence at old age and the possibility of enjoying the advantages of the retirement status are (and unfortunately shall remain) realities just for a (very) small part of Romania's population. A large part of the pensioners return on the labour market for supplementing their incomes, "forgetting" about leisure and travels, etc. Others who by nature of their profession or for medical reasons cannot round up their incomes by labour lead a life of unaccountable deprivations in order to survive. For many Romanians, to be a pensioner represents a new burden and for families to have a pensioner constitutes for certain additional costs, to a larger extent than an advantage (irrespective of its kind). Even if, according to official statistics the total population poverty rate has diminished from 35.9% in 2000 to 23% in 2004 (estimates of the World Bank), with very few exceptions, the situation of pensioners did not improve, just on the contrary.

It is more and more obvious that switching to the private pension system is the main solution for avoiding extreme poverty at retirement age. But this measure cannot solve the issue of life quality for the future third-age generation. **The medium-term collapse of the current pension system in Romania can be avoided by coherent economic policy actions/measures aiming directly at the pension system and by complementary actions for sustaining –financing, operatively and efficiency - the whole old age insurance system.**

Among the most important we remind:

- those with an overall character:

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[20] Sickness insurance, child nurturing indemnisation.

[21] Report of the High-Level Group on the future of social policy in an enlarged EU, Employment and social affairs, EC May, 2004.

- promoting a **pro-birth policy** by active measures of supporting family and children
- Enhancing the **quality** of the preventive **health care system**, increasing professionalism and responsibility. Reducing corruption and clientelism by actually promoting access equality to adequate and quality health services.
- Developing the **employment national strategy based on new competitive jobs,** on promoting competence and individual performance;
- **Sustaining career development**, encouraging entrepreneurship, **public-private partnership.**

- directly aimed at the pension system:

a) **enlarging the contributors base** by stimulating participation to optional systems, higher fiscal deductibility, supervision of funds operation, etc;

b) **increasing** the cashing **performance** of contributions, delaying instalments and enforcement for bad debtors;

c) **promoting system equity** by diminishing “exceptions” of any kind, which are unjustifiable according to objective criteria;

d) increasing the professionalism of employees responsible with **funds administration and management;**

e) finalising the **data base** and operationalising the relation fund-benefit;

f) information and **transparency on funds’ activity**, on their participation and functional efficiency;

g) increasing system equity by differentiated indexation of pensions for **gradually eliminating the group of favoured pensioners** on pensions’ calculation whose pension, by recalculation shall not be corrected by diminishing it;

h) **granting special aid for the oldest pensioners whose recalculated pension quota is below the threshold of extreme poverty** – from the state social insurance funds and from other funds (facilities regarding health assistance, assistance from local budgets for the payment of utilities, their integration in the beneficiaries’ system of charity organisations, etc.).

Annex 1 Characterization parameters of old age pension systems up to 1989

Normative Act/Period	Comprising sphere in the system/contribution	Conditions to access benefits	Pension computation
Nenițescu Act 1912-1933	Corporations' employees	a) payments in equal shares: employee, employer, state b) minimum 23 years c) 65 years	
Ioanițescu Act 1938-1949	Urbane active population		
Act 10/1949 (1949-1977)	Employees and assimilated categories (exclusively)	a) employers b) 25 years men, 20 years women	d) 50-80% from wage e) average gross monthly income for the last 12 month with ceiling at a certain amount
Act from 1977 (1977-1989)	Employees and assimilated categories, APC members, individual, non-cooperativised farmers	a) 14% from the wages fund for the employer, 2% (from 1986, 3%) from the employees; for farmers, 8% from the global production value paid by APC b) the stage increased with 5 years (30 years men, and 25 years women) c) 62 (60 on request) years men, and 57 (55) years women for employees and 65 years men, and 60 years women for farmers	d) 50-80% of wages e) the average monthly gross income in 5 consecutive years for the last 10 years, period elected by the future pensioner

Notes: a) contributions; b) contribution period; c) age limit; d) pension quota; e) computation basis.

Source: based on the legal provisions

Annex 2 Main characteristics of the system

	PAYG	Occupational schemes	Private pension funds	Life insurance of the funded pensions type[22]
Participants	Employees or assimilated, individually insured persons, unemployed	Employees of companies without debts to the state	Compulsory for persons entered for the first time in the system and under 35 years of age; Optional for persons	Individually insured

[22] Act 403/2004 transposes the EU directives provided for the insurance field and stipulates the range of life insurances applicable as of the date of EU accession. Among these are considered: the due term survival insurance, the insurance with annuities payment connected to the investment funds.

			with age between 35 and 45 years.[23]	
Contributions-benefits	Contributions defined (for 2005, 31.5% from the wage bill from which 9.5% is the contribution of the employee). The life annuity is determined on the basis of the average number of points and the value of the pension point. [24]	Defined contributions (set out based on the authorised occupational scheme)[25] Benefits defined by the life occupational schemes The amount due cannot be less than the value of adjusted paid contributions[26]	Defined contributions (2% from the wage bill in the first year with increases of 0.5% /year up to 6%). The due amount cannot be smaller than the total of adjusted contributions.[27]	Defined benefits (accumulations in life insurance accounts which on contract maturity – the retirement age – change into capital that might be integrally accessed, or under the form of life annuities.
Opening of pension rights (cumulative conditions)	-on request -on fulfilling the legal retirement age - if the contribution was for minimum 15 years – complete stage of contribution 35 (30) years men, 20 (25) years women	-On request - on fulfilling the legal retirement age - if the contribution was of minimum 60 months - personal assets are at least equal to the necessary amount for obtaining the minimum pension provided for in the norms of the Commission	-On request -on fulfilling the legal retirement age - the net personal assets are at least equal to the necessary sum for obtaining the pension	On the term provided in insurance
Restrictions on opening		A fund must have at least 100 participants	A fund[28] must have at least 50 thousands participants	
Supervision/ control		Insurance Supervision Commission	Pension Fund Supervision Commission	Insurance Supervision Commission
Market operator	Autonomous public institution of national interest	Authorised administrator (company on shares) [29]		Company on shares and/or authorised mutual company

[23] Both categories of persons must be already insured and contribute to the public pension system; it is prohibited to simultaneously participate at several private pension funds. The transfer from one pension fund to another is allowed, but withdrawal is not accepted before fulfilling the legal retirement age.
[24] The average number of points is determined on the basis of the contribution period and paid contribution; the value of the pension point is annually determined by means of the state social insurance budget and represents 30 - 50% from the calculated average gross wage used in drawing up the budget. Participation to the occupational scheme depends on labour place, and the change of the job implies entering into another occupational scheme. The transfer of accumulated funds is not allowed from one scheme to another, the benefits being paid upon retirement.
[25] The optional occupational schemes must contain the quota and periodicity of contributions, the manner of distributing them between employee and employer, the investment rules for assets as well as the methods for effecting the payment of occupational pensions, frequency, duration an updating these payments.
[26] Adjusted by the CPI before the payment of the respective contribution, and the date of withdrawal and transfer of available to the account of the participant, that is diminished with the provisions perceived by the administrator and increased with a minimum real annual profit, determined by the commission that cannot be less than 1%.
[27] The value of paid contributions is adjusted with the CPI between the payment date of the respective contribution and the retirement date, of available transfer, and of their accessories diminished with transfer penalties and legal taxes.
[28] The pension fund is constituted by public company agreement concluded between minimum 100 founding members, approved by the commission.

	(CNPAS)			
Risk insuring conditions	**Reserve fund** up to 3% from the SSF incomes, but more than the level of expenditures provided for the respective budgetary year - **transfers** from the state budget for balancing the fund	Due diligence **reserve fund**. **Guarantee fund** for occupational pensions build from the contributions of the administrators and the incomes resulting from investing these sums in bank deposits and securities.	**Reserve fund** created in accordance with the norms drawn up by the Commission. **Guarantee fund** built up from contributions of the administrators, and incomes resulting from investing these sums in bank deposits and securities.	Compulsory **safety fund** = 1/3 from the minimum solvency margin. Constitutes and maintains **technical reserves**, including mathematical for the life insurance fund.
Bankruptcy/ insured protection	State guarantee	Not guaranteed by the state and the funds can enter into bankruptcy	Special supervision Special administration during the transfer of the sums to other funds The pension fund cannot be declared as entered into bankruptcy	Turnaround plan Special administrator appointed by the Appeal Court Bucharest Judicial wind up based on the decision of the Court Assets representing the life insurance fund are used only for paying debts to the insured.

Source: legal provisions

Annex 3

Organisation and functioning principles of the pension system

Principle	PAYG	Occupational schemes	Private funds
uniqueness (the state organises and guarantees for the public system based on the same legal norms)	X		
equality (ensures for all participants, contributors and beneficiaries a non-discriminatory treatment as regards the rights and duties provided by law)	X	X	X
social solidarity (participants to the system assume mutually duties and benefit of rights for preventing, limiting or eliminating social risks provided by law)	X	X	X
compulsiveness (natural or legal persons have, in accordance with the law the duty to participate to the system, the rights of social insurance being exercised in correlation with the fulfilment of duties)	X		X (partial)
contribution (the social insurance funds are constituted based on the owned contributions, the benefits being due on grounds of paid contributions)	X	X	X
repartition (the achieved funds are redistributed for payment of dues to the public system, in accordance with the law)	X		
Autonomy in administration	X	X	X

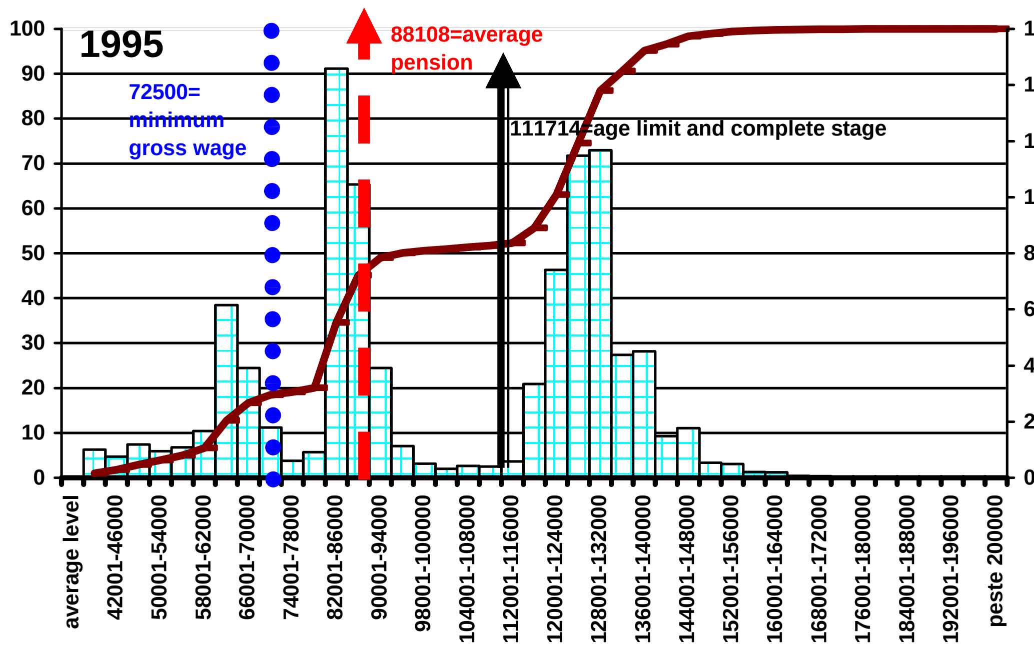
Source: specific legislation Act 19/2000, updated, Act 411/2004, Act 249/2004, Act 32/2000 updated.

[29] The administrator (company on shares) has as exclusive activity object the management of the pension funds, the calculation and payment of the private pension rights. It can manage a single private pension fund and as many other occupational schemes.

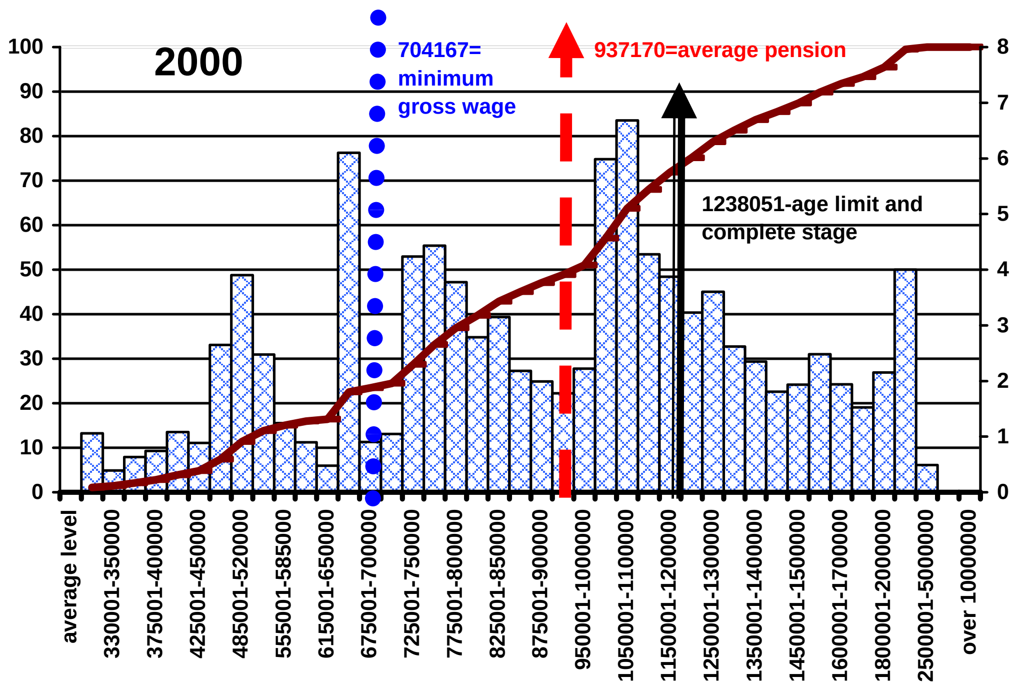
Annex 4

Pensioners' distribution on pensions' levels

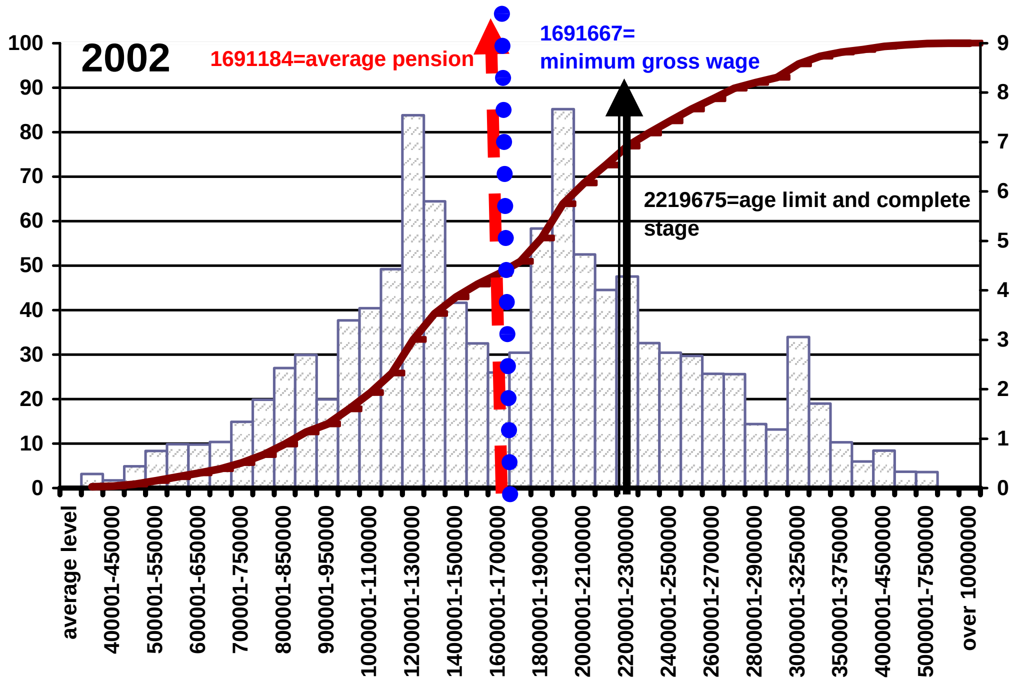
- Before the temporary measures of favouring new entries to the system (generous pensions with above-unit transfer rates)



-before enforcing Act 19/2000



-after 2 years of enforcing Act 19, of quarterly indexation (differentiated) and of pension re-correlation

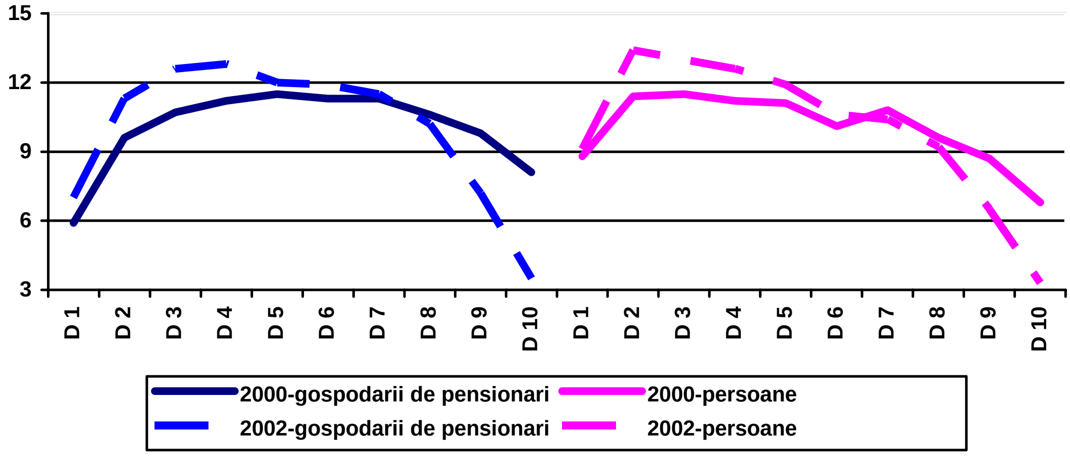


- **For 2004, after yet two years of indexation, additional re-correlation and before recalculation of pensions (data shall be available in the second quarter 2005)**

Source: based on NIS data

Annex 5

Households' distribution and distribution of pensioners within households on deciles in 2000 and 2002



Source: NIS data

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