CONSIDERATIONS CONCERNING PUBLIC PENSION SYSTEM

Emilia CLIPICI[1]

[1] Faculty of Economics, University of Pitesti, Romania, emilia.clipici@upit.ro

***Abstract**: The article addresses a topical theme at national and European level, approaching the social security scope in the context of the economic development of the globalization of the phenomena and processes on the labour market, as well as the demographic perspectives correlated to the other influencing factors. Today, in the budgets of all European countries, the pension spending is a burdening chapter, increasingly difficult to support.*

***Keywords**: social security budget, pension systems, public reforms.*

JEL Classification Codes: H55, J11, J68.

INTRODUCTION

One of the main components of social welfare model was and still is the public pension system. The maximum efficiency of the pension systems (sustainable from the fiscal point of view) was recorded in the 1970s when most European countries had succeeded in solving to a reasonable extent the issue of reducing poverty among the elderly population, without making, however, excessive expenses for the pensions. Nevertheless, today, from the macroeconomic perspective, in the budgets of all European countries, the pension spending is a burdening chapter, increasingly difficult to support, and this situation is due to the reduction of the labour, for demographic and cultural reasons, the increase of the number of retirees, on the backdrop of the population ageing, expressed by a dependency rate (the ratio between the people aged 65 and more and the persons 15-64 years old); the increase of the pension amount; the increase in the average payment term of a pension; the low contribution of the private pension system to the reduction of the pension expenses, because in most countries the system is voluntary, and in the countries where it is mandatory it has only been implemented recently; the maturity of the pension systems.

1. THE PUBLIC PENSION BUDGET DEFICIT

The reforms made at welfare level and especially at the pension system level were present in most countries (the gradual increase of the retirement age in the long term, and the limited access to early retirement, on the background of granting incentives for the extension of the working life), and were strongly influenced by demographic and political factors; however, there was a certain level of inconsistency between the adopted measures, the efficiency and persistence of their implementation, and the evolutions recorded on the labour market, and due to these inconsistencies, reforms were, in fact, insufficient (Anita M. Schwarz, Omar S. Arias, 2014).

The pension systems are built based on a simple principle: those who can earn incomes by working (taxpayers) pay for the establishment of the pensions of those who are no longer able to work (the beneficiaries), but also have a contribution history entitling them to receive a pension. Over time, the taxpayer category has widened: while initially it included only employees

working in specific sectors, nowadays this category has expanded by all employees, irrespective of their field of activity and by the increasing participation of women to the labour market. In the case of the beneficiaries, incomes were supplemented/completed for the persons in the system who, without completely ceasing work, could no longer generate a sufficient income due to the reduction of their capacity to work, however the pension has completely replaced the incomes from work, not from the moment when the capacity to work was lost, but from an age deemed reasonable for leaving the working life. The only factor that was used to regulate the level of the taxpayers and that of the beneficiaries was the demographic factor, but its action gradually decreased as the retirement age was reduced, and people’s longevity increased. Thus the number of taxpayers started to decrease, while that of the beneficiaries began to grow, but the prosperity brought to the system by the increased productivity in the labour market prevented the long-term effects of this phenomenon to be perceived in all their severity.

The situation became visibly worrying when the number of employees began to decrease in a sharp pace, due to the decrease in the number of young generations, the migration and the expansion of the study years to the detriment of the participation of the young people to the labour market.

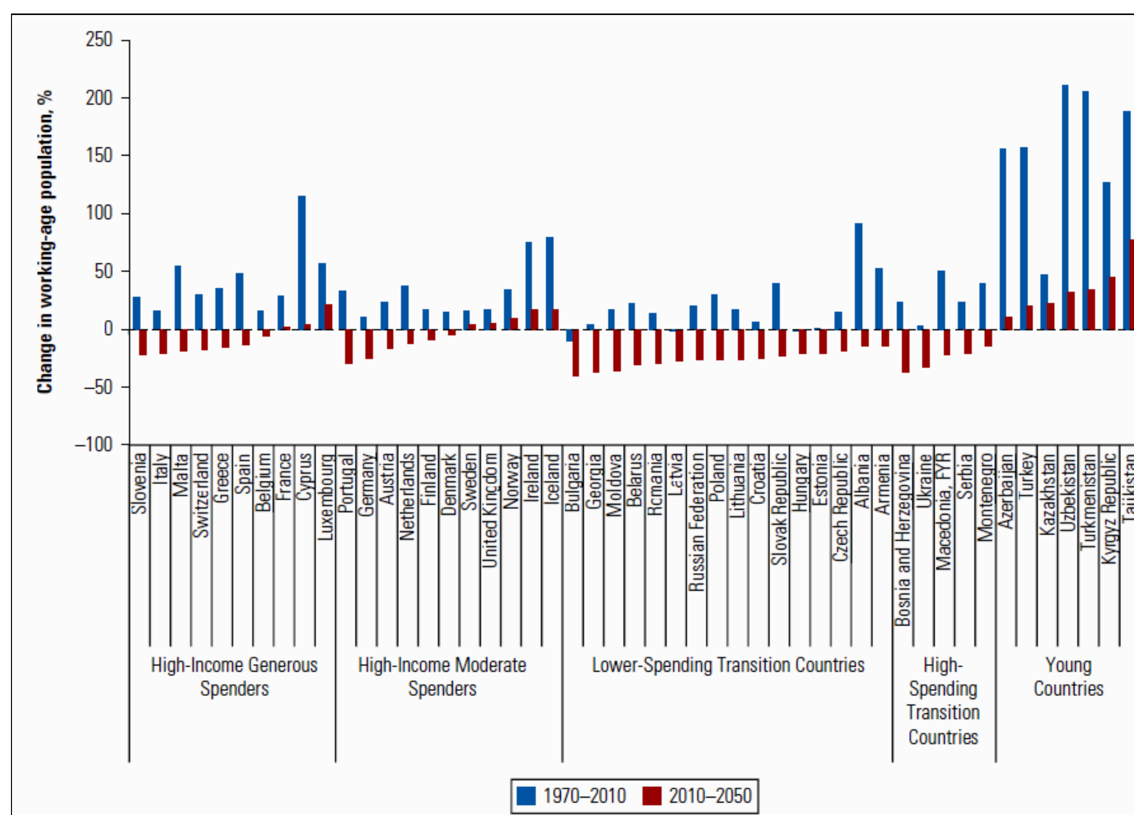

Figure 1. Change in Working-Age Population in Selected European and Central Asian Economies, 1970–2010 and 2010–2050

Source: United Nations population projections (UN 2011), in Anita M. Schwarz, Omar S. Arias, et.all, “The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia”, World Bank, 2014, p. 34.

While the current picture looks worrying enough, the retirement of the numerous generations born in the 1950s-1960s will push things even further (according to the Figure 1). According to the World Bank, around 2050 the CEE countries will have to cope on average with a public pension budget deficit of approximately 7% of the GDP (according to the Figure 2), if the pension system parameters remain unchanged.

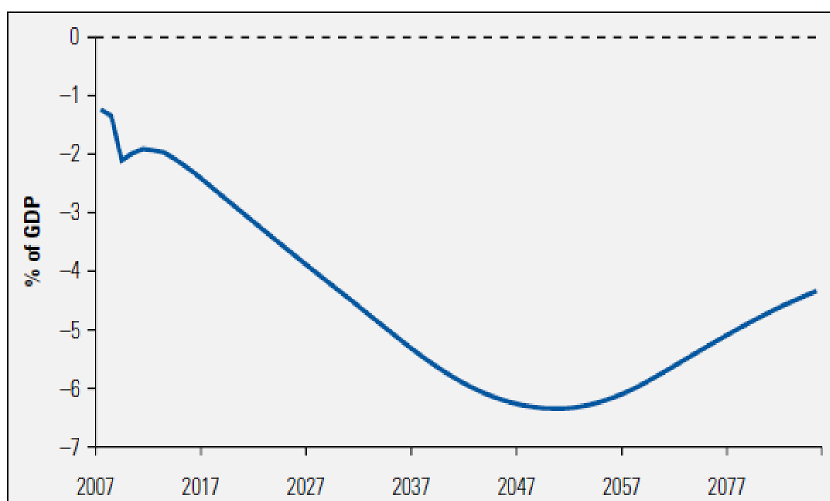

Figure 2. Projected Pension Deficits in an Average Central European Economy, 2007–2077

Source: Projections generated using World Bank's Pension Reform Options Software Toolkit (PROST), in Anita M. Schwarz, Omar S. Arias, et.all, "The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia", World Bank, 2014, p. 34.

In this context, the following short-term measures are proposed (Şeitan M, Arteni M, Nedu A, 2012):

1) Conducting a public campaign to inform the members of retirement pension finds concerning: the volatility of the incomes from investments; the detailed current and future effects on the pensions of the members from various age groups; measures to protect the poorest and the most vulnerable (such as for example the minimum pension);
2) Setting a broader framework for the payment of the pensions both by phased or deferred annuities and by the possibility of a phased withdrawal when the retirement age is reached. Allowing phased withdrawals enables members not to liquidate the invested assets until their value is recovered;
3) The implementation of a time-limited programme, in order to support the small group of persons who will retire during the crisis, which group will be the most affected. The programme can be applied in the case of the retirements in the second Pillar, providing minimum income guarantees, similar to those that were proposed in the banking system to cope with the crisis. Support should only be allocated to the persons who are very close to the retirement age and in relation to their income level;
4) Supporting the public pension systems (First pillar) so that they remain financially viable and protecting the incomes of the employees with low incomes. In this context, governments might have to finance the public pension systems from the government budget in order to offset the reduction of the contributions collected from the members or could choose to maximize the protection of the employees with low incomes, providing minimum fixed-rate pensions and the indexation of all incomes;

5) Rethinking the pension fund assets assessment rules in the context of the current extreme volatility on the financial market. Regulators and supervisors can consider relaxing the current strict rules for the assessment of all types of assets in order to level the presented evaluation when there are large movements of the prices in the short term. Some levelling during the high-volatility periods reflects real values much better and avoids potential side effects to the major short-term changes.

2. THE PENSION SYSTEM IN ROMANIA

The public pension system (*the first pillar*) is managed by the National House of Public Pensions which is coordinated by the Ministry of Labour, Family, and Social Protection. The contribution paid for the public pension is 31.3% of the gross salary income and is paid by the employer (20.8%) and by the employee (10.5%).
Under the laws in force, the standard retirement age will gradually grow, and will thus reach 60 for women and 65 for men in 2015, and 63 for women while it will remain 65 for men in 2030. Public pensions are calculated based on the individual points accumulated that are determined by the ratio between the taxpayer's salary and the average salary.

Implemented in 2007, *the mandatory privately-managed pension funds (the second pillar)* are mandatory for people who are under 35 years old and optional form persons 36 to 45 years old. The contribution to these funds was set to 2% of the gross salary income for the first year, and will grow to 6% by the end of 2016 (with an annual 0.5% increase). In 2009 the government decided to freeze the contributions to 2%, however, starting with 2010, the schedule for the increase of the contributions to the second pillar by 0.5% each year was reintroduced.
Mandatory pension funds are managed by nine private pension management companies. These companies charge, in compliance with the law, management feeds as follows:

- up to 2.5% of the paid contributions;
- up to 0.05% of the total net asset of the pension fund.

Implemented in 2006, *optional pensions (the third pensions)* allow the voluntary contribution that is limited to maximum 15% of the gross salary income. The amount representing these contributions is deductible within the limit of a sum which is the equivalent of 400 euros both for the employee and for the employer.
The standard retirement age in the case of optional pensions is 60 years both for men and for women, provided that minimum 90 monthly contributions are paid.
Private managers (pension companies, insurance companies, asset management companies) authorized and supervised by the Private Pension System Surveillance Commission may manage one or several optional pension funds. For the management of the 13 current optional pension funds, management companies charge management fees including:

- up to 5% of the paid contributions;
- up to 0.2% of the total net asset of the optional pension fund.

The optional pension funds are established by a contract of association and must reach at least 100 members after three years of activity.
Managers may only invest the assets of the optional pension funds in the financial instruments provided by the law, under the terms thereof and for the privately-managed mandatory pension funds.

In 2011, for the preparation of the country sheet on the sustainability of the pension system in Romania, based on the demographic projection at the horizon of 2060 made by the European Commission, simulations were made using the PROST (Pension Reform Options Simulation Toolkit) model - it is prepared by the World Bank with the purpose of preparing well-

substantiated policies able to decrease the gap between the quality and quantity analysis of the pension systems determining: the evolution of the evolution of the implicit debts represented by the payment of the pensions; the long-term sustainability of the pension system; the simulation of the impact of the various reform measures, such as the parametric reform (indexing method, contribution rate, retirement age) and the systemic reform (implementing the private pension pillar) - and the results were adjusted based on the experience of the Romanian experts who prepared the sheet, so as to meet the reporting requirements of the European Commission.

The result of the simulations and adjustments made was that the public pension expenditures will increase by 3.7% (13.5-9.8=3.7 percentage points, according to the Table 1, row 2, column 7 - column 2) of the GDP, between 2010 and 2060, with the highest increase between 2030 and 2040 (11.6-10.2=1.4 percentage points, according to the Table 1, row 2, column 5 - column 4), when the increase of the legal retirement age will be completed.

Table 1. Public pension expenditure projections

(% of GDP)

Indicator	2010	2020	2030	2040	2050	2060
Gross public pension expenditures	9.8	9.2	10.2	11.6	12.8	13.5
Net public pension expenditures	9.3	8.7	9.7	11.0	12.1	12.8
Public pension contributions	7.1	8.0	9.7	11.1	12.5	13.7

Source: Romania, "Country sheet on the pension projections", prepared for the Economic Policy Committee of the European Commission.

3. CONCLUSIONS

In view of the wide-spread concern with regard to population aging leading to the government expenditures of many countries to be unsustainable in the near future, some articles attempts to assess the severity with which changes in population age structure affect the budget deficit of national central governments.

By using fixed-effects panel regressions over 87 countries, some authors (Derek H. C. Chen, 2004) find that there is some evidence that increases in the elderly and youth population shares tend to increase the budget deficit, but only in developing countries. In addition, there is some indication that these age-structure effects on the budget deficit occur as a consequence of negative bequest motives.

The countries have many posibilities to improve the pension system. They can:

- cut other expenditure to make more fiscal room for pension spending
- revisit their pension spending priorities to see whether there is anything that can be reduced or eliminated
- increase the labor force, either by raising retirement ages or by encouraging immigration (the raising retirement ages affects both the expenditure and revenue sides of the pension balance, while immigration affects only the revenue side, and also increases long-term liabilities), etc

Other countries have promoted low-cost, well-managed pension organisations that are better oriented to the needs of low income households, for example National Employment Savings Trust (NEST) in the United Kingdom, which acts as the default in the new national automatic enrolment programme.

Private pension arrangements have been growing in importance in recent years as pension reforms have reduced public pension entitlements. In many countries (18 OECD countries), private pensions are mandatory or quasi-mandatory (that is, they achieve near-universal coverage of employees through collective bargaining agreements).

In a further eight OECD countries, voluntary private pensions (occupational and personal) cover more than 40% of the working age population. These may be the solutions to this crisis of population ageing.

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