

EARLY RETIREMENT

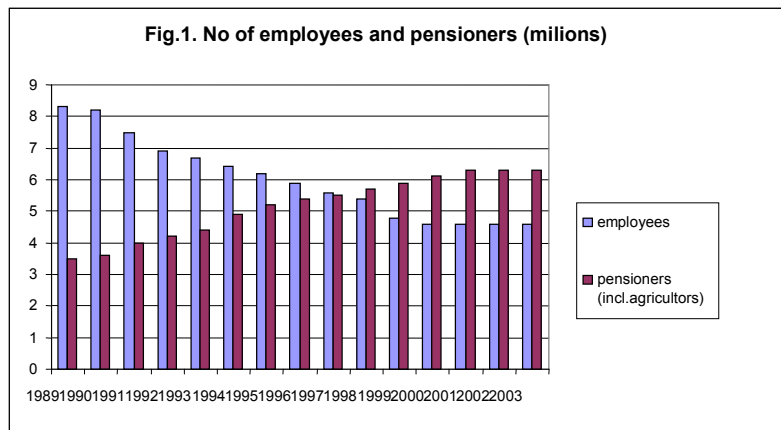
The Disease of the Romanian Pension System?

Suzana Dobre argues there are not available resources within the pension fund to allow a significant improvement of pension value and a reform focused only on raising the retirement age have proved insufficient and more input is needed for encouraging employment.

For the first time since 1990 we saw pensioners protesting on streets because their pensions don't meet their expectations after their entire working life contributions. Trade unions argue also for higher pensions. Politicians are reluctant to say NO to such a large share of electorate but the government has to cope on the other hand with financial constraints. The government argues that the pensions have already increased and in the next two years they will grow with a further 15%. But the pension fund is not doing very well from the financial point of view and will have to deal with new challenges such as private pensions in the short run and with the more threatening demographic projections.

In this paper we have analysed the pension policies since 1990 and the effectiveness of the reforms implemented so far. Further we have analysed the current situation and we have looked whether the public scheme can afford higher pensions and what conditions have to be fulfilled for this purpose.

Nowadays everybody agrees that at the Romanian economy in the early '90s had intrinsic faults and the need for restructuring was imperative. But it was not always perceived so, as the infamous slogan "we don't sell our country" was once so popular. In the early '90s, the Romanian governments lacked both the vision and the will to start early a real transformation. Instead they delayed any reforms and dumped the costs of keeping alive such dis-functional structures on the pension system. Early retirement was the word of the day. As a result the pension system entered into a complete disarray while the number of pensioners rocketed to the sky. In 1990-1996 the number of pensioners increased with 46% and upwards trend continued throughout the decade. In addition the number of employees declined continuously. In 1990 the pensioner/employee dependency rate was 0.42 similar to most of Western European countries¹. Ten years later the dependency ratio was three times as high, meaning that each employee was supporting 1.32 pensioners. The result – a total disbalance of the pension scheme that will take decades to solve.



Source: calculations based on NIS (2005)

¹ UK - 0.4, France - 0.5, Italy sticking out with a 0.7 (Bogaart, 2004)

Category*	1990	1992	1999	2001	2002	2003	2004	2005	2006
Group 1	15	35	40	45	45	44	41.5	39.5	40
Group 2	15	30	35	40	40	39	36.5	34.5	35
Group 3	15	25	30	35	35	34	31.5	29.5	30

* differentiated by working conditions and occupational risks

In 2000, new laws on pensions have been adopted aiming to limit early retirement. The age threshold for retirement has been raised gradually to reach 60 years for women and 65 for men over a 13-year period. The contribution periods have been also modified with a similar gradual implementation. The minimum contribution period has risen from 10 to 15 years while the full contribution period has become 30 years for female workers and 35 for male, 5 years longer than before. As a result, the increase in the number of pensioners has slowed down. Since 2001 the number of pensioners has grown significantly slower with an annual growth rate lower than 1%, even reaching 0.31% in 2005, compared to 4-5% before, but the dependency ratio remains high.

Despite the reform, the uninspired early retirement policy of the '90s still has and it will continue to produce negative effects on the pension system and generally on the economy, a long time from now. The public system is a Pay-as-You-Go type meaning that the pensions of the current pensioners are paid from the contribution of the current employees. It is not easy to keep a financial equilibrium in such disbalanced situation where the benefit recipients are so numerous and the contributors so few. The choices are limited and unpopular:

- To burden the contributors with high taxes,
 - To decrease the real value of pensions and
 - To supplement the pension fund with subventions from public budget.
- The governments have tried all of them.

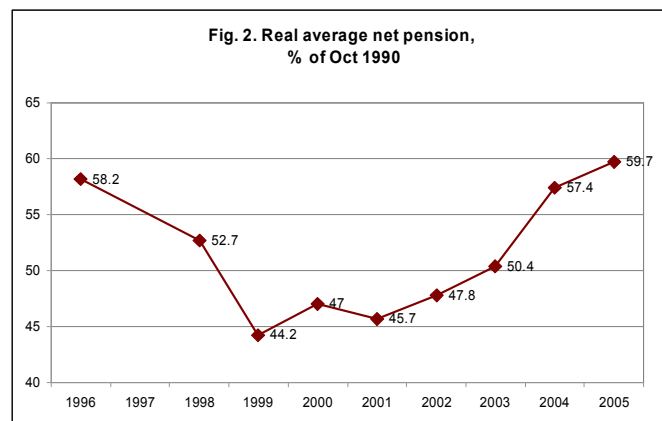
Tax burden

The deterioration of the dependency ratio is clearly reflected in the evolution of the social insurance contributions. At the beginning of the '90s the contribution was 15% of the gross salary. Trying to provide resources to the nearly collapsing pension system the percentage of social insurance contributions out of gross salary was increased three times by

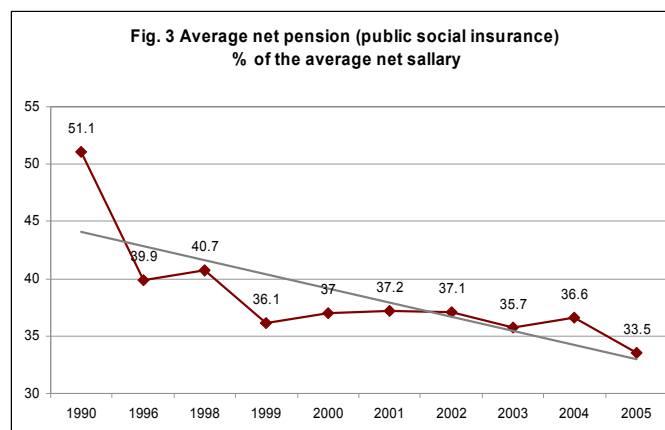
2001 (table 1). The direct effect is the burdening of the economy, as these contributions, no matter whether supported by the employer or employee, have raised significantly the cost of labour.

Pensions real value

The pension real value has declined in time. The incomes of pensioners are smaller than in 1990 no matter what criteria we apply. The average pension value (in real terms) is only 59.7% of the 1990 figure, but higher than the minimum of 44.2% in 1999. It means that current pensioners are doing better than five years ago but still they are much **poorer than at the beginning of the '90s**.



Source: CNPAS



Source: CNPAS

If we consider the replacement rate, the average net pension dropped from a 51% of the net average salary in 1990 to 33.5 % in 2005 and the trend is still descendent. It is explicable as the indexation of pensions followed the inflation rate while the salaries are growing faster following the logic of the market with several other determinants such as productivity, general economic evolution etc. Whatever the reasons the result is that pensioners are becoming **poorer compared to the rest of the society.**

Finances of Pension Fund

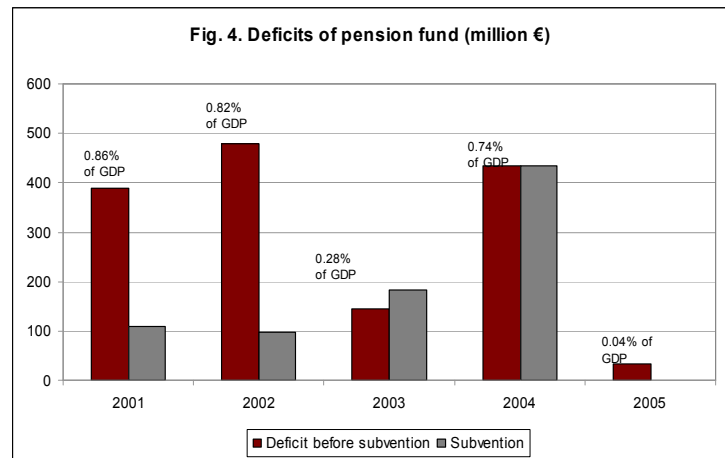
The rise of taxes and the decrease in the real value of the pension have not been sufficient. The situation of the pension finances has been awkward since 1990. In mid 90s it was separated from the public budget and become the social insurance fund. Out of this fund payments were made for the state social insurance pensions, maternity leaves, farmers' pensions. Even though the total expenditure for pensions represents a smaller share of the Romanian GDP (8%) compared to the EU25 average of 12.5%, they are still too high when compared with the fund's revenues. The pension fund (before subventions) has had deficits since its inception and in some years the deficit reached almost 400 million EUROS representing more than 0.8% of the GDP. The only year when the fund had a positive result was in 2003 when it received a significant subvention from public budget.

In 2005, the government shifted the costs for maternity and temporary work incapacity leaves and agricultors pensions to the health insurance fund and public budget but the data for 2005 still indicate a deficit.

We will not see favourable demographic developments in the future so a natural rebalance of the pension system is implausible. By contrary, the demographic projections are worrisome. UN population projections² indicate that the age group of 65+ will represent almost a fifth (18.9 %) of the population of Romania by 2030, compared to 10.4% in 1990 and 14.8% in 2005. It actually means that the largest cohorts of baby boomers born after Ceausescu's decree will reach retiring age exactly when the small

cohorts of children born after 1990 will form the majority of the workforce and will have to pay for the pensions of the former. The age dependency³ ratio is therefore likely to worsen affecting implicitly the pension system.

All these elements point to the need for urgent reforms of the pension system as the current status is poor and the prospects are even worse. But what elements of reform can be further considered?



Rising the retirement age a panacea?

Rising the retirement age is considered good practice in all aging societies. It is assumed to act positively at both ends: firstly it increases the workforce participation and secondly it lowers the number of new pensioners. Using model calculations ILO⁴ showed that a raise of the retirement age, combined with other labour force policies, can slow down significantly the deterioration of the system dependency ratio, even in societies facing rapid ageing. Following the general practice, the 2000 reform⁵ has gradually risen the retirement age over a period of 15 years. From a retirement age of 57 for women and 62 for man, the law 19/2000 has increased it to 60 for women and 65 for men.

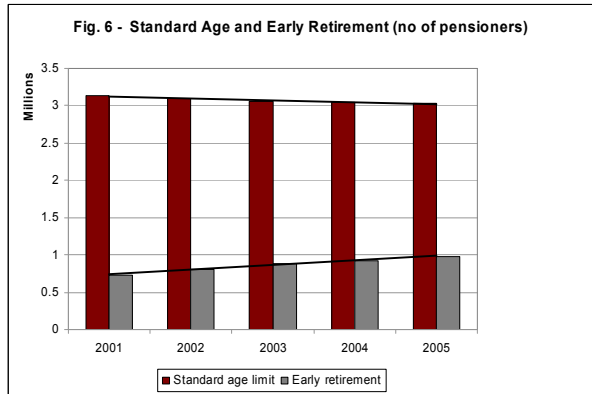
At the first glance, one can argue that these changes have been beneficial and the results are becoming visible. As pointed out above, the annual growth rate in the number of pensioners has had an important decline. However, when checking other indicators the situation proves to

³ Age dependency represents the ratio of the elderly (65+) to the younger population. It is different from system dependency calculated as the ratio of pensioners to contributors to social insurance system.

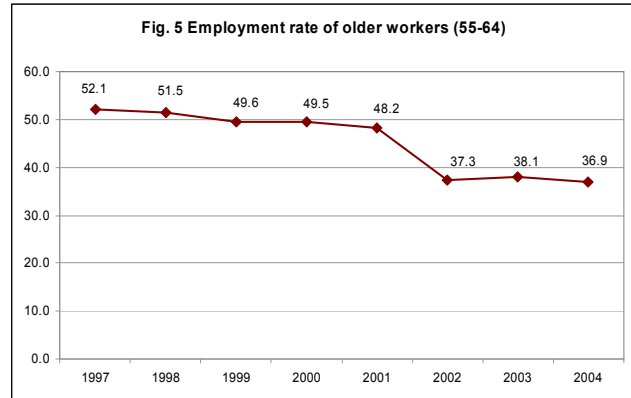
⁴ ILO (2001) - *Social security: Issues, challenges and prospects*, Report VI, International Labour Office, Geneva

⁵ Law 19/2000

² World Population Prospects – The 2004 Revision Population Database (<http://esa.un.org/unpp/>)



Source: CNPAS



Source: Eurostat

be more complex. The average exit age from labour market should have increased, but in reality it has dropped from 59.8 years in 2001 to 59.5 in 2004⁶. The employment rate for older workers (55-64) has also decline with a steep fall exactly in 2001-2002 when the law started to be implemented. Is this simple coincidence? It is hard to say. Anyway the trend is not in the right direction. We are moving away from the target of 50% by 2010 for the employment rate of older workers as established at the Stockholm European Council in March 2001.

It means that the policy of raising the retiring age was successful at one end – to lower the number of new pensioners, but failed at the other end - maintaining the workforce participation of older workers.

A closer look to the legal provisions and the retirement patterns since 2001 might explain some of these trends. Alongside the the oficial increase of the retirement age, the law 19/2000 provided some alternative routes for early retirement – anticipated retirement, partially anticipated retirement and disability pensions, to qualify for any of them one having to be met certain conditions. In the 2001-2005 period it can be noticed that the number of people retired at the standard age limit has slowly decreased while the number of people retired early continued to grow conserving the trend existing before the 2000 reform. Another negative impact on the rates of early retirement could be brought by an early deterioration of health in the population. The WHO indicates a very low level of healthy life expectancy (HALE)⁷ for Romania. In 2002 HALE at birth was around 63 years (for

men 61) while in most Western Europe is over 70. It means that the policy of rising the retirement age is more likely to have an impact in countries where the age of retirement is significantly lower than life expectancy and than healthy life expectancy, while in Romania its effectiveness would be less obvious. As these two indicators are correlated with the level of economic development and the quality of life, the early retirement on health deterioration grounds is likely to diminish as the overall development and health protection in Romania will progress.

Anticipated retirement grants the possibility to retire 5 years earlier than the standard age of retirement for insured people that have had a contribution period with at least 10 years longer than the standard one. There are no financial penalties, the calculation of the pension following the same criteria as the regular retirement.

Partially anticipated retirement opens retirement possibilities for the insured people that contributed to the system the standard period or more (up to 10 years). They benefit from a maximum 5 year reduction of the retirement age but they are financially penalised.

The **disability pension** can be granted to people that have lost entirely or partially the capacity to work as certified by an official expertise.

Depending on the degree of disablement, the pensioners are classified in three categories and the value of the pension is calculated taking into account the age when disability occurred, the period of prior contributions and the disability category.

⁶ Eurostat

⁷ expected length of life spent in good health. Healthy life expectancy (HALE), results from subtracting estimated years of life spent with illness and disability from estimated life expectancy.

	2001	2002	2003	2004	2005
Anticipated Pension	3,791	7,883	11,202	11,667	12,031
Partially Anticipated Pension	36,646	78,890	102,206	108,896	116,626
Disability Pension	682,782	719,891	766,471	801,722	842,869

Source: CNPAS

In conclusion raising the retirement age alone, despite of its positive effects, is not sufficient to ensure a sustainable development of the pension system and to provide sufficient resources for a decent living in old age. SAR has argued from the inception of the pension reform that raising the retirement age alone is not sufficient⁸ and further steps have to be taken. Unfortunately our arguments have been confirmed in time.

Recently, politicians throughout the political spectrum argue for an increase in the value of the pensions, some even risked coming up with figures for a minimum pension. However, what are the implications and feasibility of such proposals?

The pensions of current pensioners are paid from the contributions of current employees thus the value of pension is depending on:

- the percentage of gross income paid to the fund
- the number of recipients and
- the number of contributors.

Further we will use these three variables to analyse if pensions could be increased without creating new deficits and what conditions should be satisfied.

1. Is the pension fund able to support an increase of average pension with the current number of contributors and the current number of beneficiaries?

We used the most recent figures presented by the Ministry of Work, Social Solidarity and Family for the average number of pensioners and contributors as well as for the average gross income. Based on the most recent data we consider an average rate of 91% for collecting contributions and costs for administration amounting to 3% of total.

Calculations indicate that considering the current number of employees with the present average gross income and the current number pensioners, the fund can support an average pension of 303 RON without running deficits while the current average pension is 301 RON.

Given the ongoing process of re-calculation of pensions that will increase anyway the average value of pensions, further increases are not possible without creating deficits.

2. What conditions would allow an average pension of 150 EURO?

In the second case we targeted an average pension of 150EURO (equivalent of 525 RON) using the same calculation base and a collection rate of 91%. The result indicates that such increase would bring significant additional costs and new resources would have to be attracted. The percentage paid as **contribution** is already high compared to other countries from the region and given the impact on the economy it is unlikely to see an upward modification. The **number of pensioners** is impossible to decrease significantly in the short and medium term as the raise in the retirement age has almost reached its limits as proven above. Therefore the **number of contributors** is the only variable that could allow an increase in the value of the pension.

Calculations indicate that an average pension of 150EURO needs more than 8,000,000 people to contribute to the pension fund representing an increase of 85%. If we consider the figures vehiculated in the media of 700 RON (approximately 200EURO) than the number of contributors should be more than 11 million people.

In conclusion an increase in the value of pensions has to be gradual and only if the revenues increase. For this purpose, a basic condition is to make sure that resources that are already at scarce will not be wasted because of deficiencies in collection. To enforce a good collection rate is the quickest way of bring more money into the pension fund, although the supplements will not be very consistent. Secondly, as raising the contribution rate is not appealing for anybody, nor employers or employees, than only a general improvement in the employment rate will ensure the necessary base for covering the costs of pensions providing more revenues to the pension fund and a better spread of burden.

⁸ Warning: Risky Social Security Management Early Warning Report 4/2002, Romanian Academic Society

Recommendations

1. Better enforcement of standard age

Clearly the system continues to provide incentives for the use of early retirement routes if an increasing number of people use the anticipated and partially anticipated retirement schemes. Even more the system allows the possibility of abusing these schemes. Recently the media reported the situation of several high-level employees in the Ministry of Defense who retired using the anticipated schemes but got re-employed exactly on the same positions as civilians. In the end they have kept the same jobs, only that in addition to the salary they receive pensions as well. In conclusion, the Government has to eliminate or at least diminish the incentives for early retirement and to guard the system more effectively against abuses.

The Government should focus on enforcing the existing standard age by putting more conditionality in the eligibility for early retirement and by adding in more convincing disincentives such as the increase in the penalties for retiring before the standard age.

In addition, the opening of the second and third pillars of pensions system and the encouragement of private savings would allow the individual to have a better control over the exit (partial or total) from the working life without burdening the public scheme.

2. Promote continuous and longer working life

It is important to preserve the quality and adequacy of skills ensuring the employability of workers throughout the working life, especially of older workers. Currently Romania has one of the lowest rates of participation of workers in training and re- or up-skilling so a policy intervention is necessary in order to make continuous education the norm rather than the exception as it features at present.

One could argue for a more flexible work pattern towards the retirement age for people that face a partial deterioration of the work capacity. However, policy-makers should be cautious in proposing such policies as it can have adverse results. Studies indicate that flexible work for older workers determined an increase in partial retirement before the age while the percentage of people retiring early remained unchanged. So it was the people that would otherwise work full-time until standard age, that have taken part-time jobs. However, the possibility to continue to

work after the age of retirement on part-time basis could cater for people able and willing to stay active.

3. Improve participation of working age people, especially of those currently inactive (women, Roma, people with disabilities, people in rural areas)

The entrance in the labour market should be eased for certain groups with a lower participation at present. For this purpose a cross sectorial strategy is needed combining policies targeted at increasing participation in education, vocational and long-life training, encouraging provision of affordable care for children and elderly, provision of adapted work conditions etc. However such strategy should be based on a comprehensive assessment of the situation of each group and should be designed with the participation of all stakeholders. Any sectoral strategies should take into account what effects they might have upon the system of pensions.

In conclusion, the pension system after 16 years of reforms finds itself into a critical situation with more pensioners than contributors, running deficits and providing small returns to the current pensioners while charging high current employees. All these troubles have been created mainly by the early retirement policies intensively used in the previous decade. The future will bring further challenges as the demographic projections are grim. Given the feeble situation of the public pension fund it is very unlikely to be able to cope with the retirement of large cohorts of baby-boomers when the working force is shrinking. So far the reform focused on limiting early retirement but the success is partial and further reforms are imperious necessary for a better enforcement of standard retirement age and for increasing the number of people in employment. The opening of private pension schemes, although not discussed in this paper, would allow people more flexible arrangements in the old age without burdening the public schemes. It creates additional financial pressures on pension fund on short run but the long term benefits are likely to overcome the shortcomings.

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