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Romania social briefing:

Pension System in Romania

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Pension System in Romania

Romania's pensions system since 1990 is based on the solidarity between generations, meaning that pensions are paid based on the contributions of current employees. Starting with 2008, two other pension Pillars where added to this system, under which funds are privately managed and invested. Still, the system continues to be largely dependent on the state pension, which is no longer sustainable due to decreases in the birth rate, emigration and other specific problems of the labour market. A new reform of the pensions system is envisaged under the National Recovery and Resilience Plan, with the aim of being presented to the Parliament until the end of 2022. However, the measures are delicate and bitter for the political party assuming them.

Similar to other socialist countries, after the 1990s, Romania's pension system was based on the principle "pay as you go", in which retirees were paid from the contributions of current employees, while the amount of pensions was related to the level of income, based on periods of minimum contribution. In such pension system, the dependency ratio between the number of retirees and the number of employees, which are the contributors to the pension system, is highly important. From a good dependency ratio of 3.42 in 1990 in Romania, the situation has constantly deteriorated. The demographic change has created problems for the pension system, as the population has declined due to the negative rate of growth and emigration. Another reason for the change in the dependency rate was early retirement. During the years, the labour law was frequently changed, allowing at some point the retirement at age 50 for women and at age 55 for men, and the introduction of a number of professions into a higher risk category, which enabled early retirement with full rights.

The first major overhaul of the pensions system was made in 2000. Back then, the envisaged measures intended the creation of a second pillar of pensions, besides the pension provided by the state, with mandatory contributions privately managed. A third pillar of pensions was also introduced, formed by optional contributions. The introduction of the second and third pillars faced the opposition of employee unions, who wanted to be better involved in the design of the system. Therefore, the law was adopted in the last period of the mandate of the Government back then and immediately cancelled in the first meeting of the new Government. However, the problems have continued. There was a drastically decrease in the number of employees, an increase in the number of the retirees having special pensions based on their belonging to some professional categories, the reduction of the revenues to the state budget as well as the large number of early retirements. As a consequence, the principle of "solidarity between the generations" has become dysfunctional not only in Romania, but on a European scale, and it was replaced by the principle of benefiting of lifelong savings at the retirement age. In 2008, at the recommendation of the World Bank, the law which is currently available has entered into force, regulating the pensions system in Romania on three pillars, quite similar to the ones proposed in 2000.

Therefore, the pension system in Romania is currently structured on three Pension Pillars, as follows: Pillar I – the public pension system; Pillar II – compulsory pensions privately managed; Pillar III – voluntary pensions. The first pillar continues to function under the format of a redistributive system, based on intergenerational solidarity according to which the contributions of current employees are forming the budget of social insurance funds, from where pensions to the retirees in the system are granted. The pensions are calculated based on a "pension point" which is established by the policy makers.

Under Pillar II, a part of the contribution to social insurance funds are redirected towards private companies that will further invest the money. In 2008, the amount of the contribution was established at 2% of the gross salary, intended to increase to 6% within 10 years. At present, the share of social security contributions is 25% of the gross salary. A percentage of 21.25% is directed to Pillar I (public pension), and, due to successive amendments to the legislation, the amount transferred to Pillar II remained capped at 3.75% instead increasing to 6%. Pillar II has been designed to be mandatory, in order to ensure savings for each citizen. Therefore, the amounts to the second Pillar are collected from each employee's individual contribution to social insurance funds. Pillar III has a similar functioning mechanism, only that there is a distinct contribution that will be collected from the gross monthly salary income, on a voluntary basis. Both Pillars II and III are funds entirely independent of the state budget and under the management of financial institutions, free of political intervention. The effective private pension at the retirement age under Pillars II and III will depend on the money collected in the individual accounts, so on the contributions made during the active life, but also on the return obtained from the investments made by the fund administrator. However, the total amount due may not be less than the value of the contributions paid. The privately managed funds had good return on investments so far. The total return achieved by the Pillar II pension funds, starting with 2008 until the end of 2019, corresponds to an average annual return of 8.35%. In 2019, Pillar II recorded the best yield in the last 9 years. There are seven mandatory private pension funds which achieved an average yield of 11.8% in 2019. The evolution was good even during the pandemic.

Despite the reform of the pensions in 2008, the pensions system did not improve its sustainability, as it is still largely dependent on the first Pillar (the state pension). Here, the problems are structural, given that there are too few contributors and too many retirees, which generates a problem of financial sustainability that will worsen in the coming years. In Romania, there are currently 5.2 million pensions and 5.6 million active employees (without including civil servants and staff in the public order and defence system), according to the National Institute of Statistics. In addition, the effective retirement age is much lower than the European average, certain professional categories having the privilege to retire at 45 years. Under the continuous decrease of the birth rate and increased emigration, forecasts indicated that it risks collapse in 2030, when a large number of actual employees will reach the retirement age.

Policymakers are considering a new reform of the pensions, at present under the auspices of the National Recovery and Resilience Plan (NRRP), although the topic was systematically on the agenda of Romanian Governments. The European Commission calls on the Government to make the pension system sustainable, meaning to keep spending at its current level. The NRRP provisions, drawn by the Romania policymakers, provides some important points for balancing the pension system. The general objective of the pension system reform is to achieve a new legislative framework to correct inequities, to respond to the Country Specific Recommendations of the European Commission, to ensure the sustainability and predictability of the system and to respect the principle of contributory beneficiaries of pension rights. However, these provisions caused tensions not only in the public space, but even within the governing Coalition. Among them, there are the elimination of the possibility of early retirement; raising the standard retirement age (from 65 years for men and 63 for women at present) in order to be correlated with life expectancy; freezing pensions at the current level, but with targeted increases for minimum pensions; maintaining a full contribution period of 35 years both for women and men and revisiting the exceptions for various professional categories; changing the way the pension is calculated, based on a stable formula and an automatic indexation, instead of ad-hoc increases, which would ensure the medium- and long-term predictability of pension expenditure, thus eliminating all possibilities of intervention due to political interests.

However, the reform of the pension system is a very delicate and unpopular topic. In addition, it is very difficult to be managed, as the laws on special pensions was defended by various decisions of the Constitutional Court so far. It is clear that the losses in terms of popularity and public appreciation for the party trying to enhance such a reform are very high. However, the measures, delayed in the last years, have to be taken. Romania has a large budget deficit, where the contribution of the pensions system is significant. Such a deficit is difficult to be financed if the interest rates at international level will increase, therefore measures for its reduction are becoming urgent. In addition, according to specialists, the budget cannot be financed only through economic growth, since the nature of the problems is structural.

For the moment, even the provisions of the NRRP are contradicted by policymakers, in an attempt of calming the situation, therefore no clear path is established yet. However, the measures cannot be postponed for too long. The Minister of Labour stated that a new reform law for the pension system will be presented in Parliament by the end of 2022, in order to fulfil the schedule submitted under the NRRP.