CONSIDERATIONS ON THE REFORM OF PENSION SYSTEMS IN ROMANIA AND HUNGARY

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1. Introduction

Pensions are the main instruments through which states provide citizens with an acceptable level of retirement wealth. "Providing adequate and sustainable pensions for the EU citizens is a priority for the EU for the time being and for the future. Achieving these goals in an aging Europe is a major challenge[1].

In the last decade the ratio of young people, aged between 15 and 65 and those who are on the verge of retirement has fallen by 15% at the EU level. Eurostat predicts a doubling of the expenditure on pensions in the GDP over the next 50 years.

Regarding the situation of Romania, Eurostat forecast indicates an increase of the pension expenditure in GDP by 88% from 8.4% of GDP in 2010 to 16% by 2050. Countries from all over the world are facing major budget problems which consist of the increase in pension expenditures due to population aging (see chart no.1).

Awareness of this phenomenon has sparked a widespread debate in all EU member states and around the world regarding the reform of the national pension systems. However, pension reform is difficult because of the economic, demographic, social and political aspects which need to be taken into consideration.

Pension systems in EU Member States are organized as state pension systems and are regulated at the state level. Depending on how the pension system is organized we can distinguish four country[2] categories :

-countries with public pension systems as pay as you go (PAYG): Slovakia, Sweden, Romania, Poland, Hungary, Latvia, Lithuania, Estonia, Bulgaria;

-countries with developed private pension systems as: Britain, Denmark, Netherlands;

-countries with underdeveloped private pension systems as: Spain, France;

-countries with a traditional pension system, which went to private pension systems: Italy, Austria, Germany.

2. The Romanian pension system

According to the Romanian legislation, the pension system is composed of the following pillars:

-pillar I: a PAYG type- a compulsory component of public administrators, the legal framework for this pillar is regulated by Law 263/2010;

-the second pillar: a compulsory privately managed component, the legal framework for this pillar is regulated by Law 411/2004 regarding private pension funds as they are amended by Law No. 23/2007;

-pillar III: an optional component privately managed, the legal framework is governed by Law 204/2006 regarding the optional pensions.

Pillar I is compulsory and represents the public pensions which are

[1] Green Book-By appropriate to pension systems, viable and safe,Bruxelles 2010,page 2

[2] www.cspp.ro

paid by the state. Pillar I funding is provided on redistribution, the social insurance budget being formed based on the contributions of the active population.

As a part of the public administration the role of pillar I is to ensure a basic pension which is guaranteed through state guarantees. The amount of the pension depends on the obtained income during the working period and on the pension point value.

The pension categories of pillar I are: old-age pension, early retirement, partial early retirement pension, invalidity pension, survivor's pension.

Pillar II is compulsory for those aged up to 35 years when this go in force. The funding of this pillar is based on accumulation and it represents the pensions which are managed by the companies under the authorisation and control of the Supervisory Commission of the Private Pension System.

The contribution to this pillar consists of diverting 3% of the social contributions for 2011 to one of the companies that manages facultative pensions. The role of Pillar II is to complete the basic pension in order to ensure the pensioner's financial independence which is guaranteed through a guarantee fund.

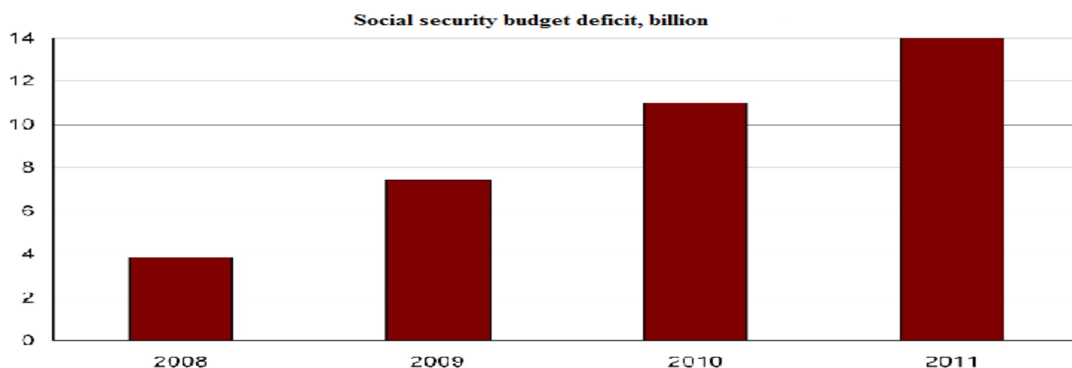
The amount of the pension depends on the revenue made by the participants in the pension fund and the period for which they contributed.

Pillar III is optional, and its funding is based on accumulation. The contribution to pillar III is made of the insured's gross monthly salary and it is limited to an amount which is equivalent to 400 euros in a fiscal year.

The role of Pillar III is to complete the pension obtained from pillar I and II in order to ensure a high standard of living. The amount of the pension depends on the contributions made by the participants in the pension fund and the period for which they contributed.

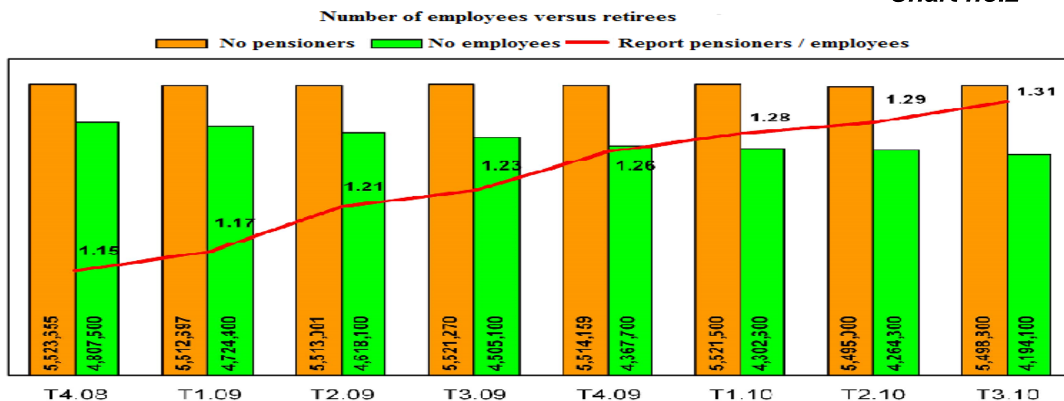
The pension system in Romania has undergone several reforms over time in order to improve the sustainability of a system that faces significant demographic challenges. Out of 10 million people, active population, only 5.8 million contribute to the pension system, the reform having as purpose the creation of an equitable redistribution and creating a closer link between the contributions made and the benefits received (see chart no.2 and chart no 3).

Chart no. 1



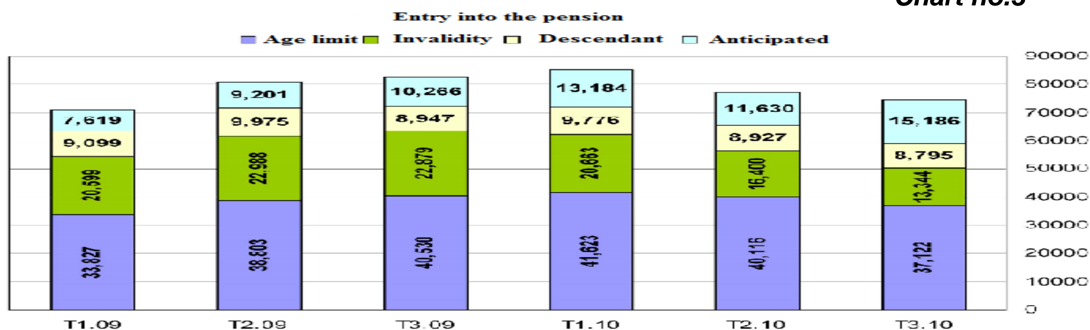
Source : www.businessday.ro

Chart no.2



Source : www.businessday.ro

Chart no.3



Source : www.businessday.ro

Among the features[3] of the new pension system in Romania we can include:

- raising the retirement age from 57 to 63 years for women and from 62 to 65 years for men, the increase taking place gradually until 2014;
- increasing the minimum contribution period for both women and men from 10 to 15 years;
- introducing a new pension formulas based on a points system which takes into account the income of the insured throughout the period of contribution.

3. The Hungarian pension system

With a total population of over 10.000.000 inhabitants, of which over 17% over 65 years, Hungary is the first country in Central and Eastern Europe which reformed its public pension system by introducing the multi-system (pillar I,II, III, IV pension), system which involves employers, insurance holder, financial companies. In Hungary the ratio between the economically inactive people and the number of working age people is 23.5%, percentage which, according to specialists, is expected to double by the end of 2060 to over 57%. With a minimum wage of 270 euro, almost double than the minimum wage in Romania and an average retirement age of 60 years, Hungary opts for the compulsory pension insurance in a system composed of two levels.

The first tier is a pay-as-you-go and it is about ¾ of the mandatory pension system. The second tier is organized as a private pension scheme which operates on the principle of

[3] National Strategic Report on social protection and social inclusion 2008-2010,Government of Romania, page 10

capitalizating the contributions of the participants in a private pension system and it represents ¼ of a mandatory pension system. The Hungarian pension system consists of the following pillars:

Pillar I- the state system is of the type pay as you go and it is compulsory. The contribution to the first pillar represents 18.5% of the gross income and it is supported in the following proportions: 0,5% by the employee and 18% by the employer and the employer. The legal retirement age is 62 for both women and men. Pillar I is a DB (defined benefit) system type – with defined benefits (a benefit is determined and the contributions which are necessary to achieve that benefit are calculated).

Pillar II – it is compulsory for new entrants into the workforce, people who are aged under 35. For people who fall under the second pillar it is optional. The contributions to pillar II are 8% of the gross salary, rate which may increase obtionally by another 2% under the form of additional contributions. Pillar II is a DC (defined Contribution) system type – with defined contributions (benefits which vary depending on the results of the participant's investment fund assets). Under Pillar II both contributions and benefits for contributors are exempted from tax.

Pillar III - was launched in the mid of 1994 and it is a voluntary scheme with defined contributions and individual accounts.

Pillar IV - was launched in 2007 and it is a voluntary system of occupational pensions, according to the working contracts.

Hungary has a special, fund[4] for the protection of capital accumulations, which is quarterly financed through compulsory contributions and which represents between 0.3-0.5% of the contributions value. The purpose of this protective fund is to protect both pensioners' total benefit and taxpayers accumulated capital in the event of insolvency. In 2010, 8% of the social security contributions payable by employees, on a rate of 9.5%[5], were monthly transferred to employees' personal accounts to the mandatory private pension funds, the value of these transfers reaching 100 million euro. In October 2010 the Hungarian government decided to suspend the monthly transfers to the mandatory private pension funds (pillar II) from November of that year.

Through the nationalization of the money accumulated in employees' personal accounts to the mandatory private funds, the Hungarian State manages to erase debts of over 5 billion by canceling government securities in the portfolio of pension funds and obtaining a reduction of over 4% of the debt in GDP. Being a temporary decision of stopping the transfers to private pension funds, it has contributed to a considerable reduction of the budget deficit, but certainly it has canceled many of the measures to reform the pension system adopted by the Hungarian State from 1998 to present day.

4.Conclusions

The economic and financial crisis led to a deterioration of public finances and to a sharp increase in public deficits and debt levels, which clearly affects the public spending programs on social protection. In addition, we are witnessing a reduction of investments in private pension funds and an increased uncertainty regarding the extent to which they will be recovered.

Therefore we need a careful review of pension policies in order to provide a sustainable and adequate retirement income, because developed countries are forced to allocate an increasing proportion of of GDP for the older generation The Member States will

[4] www.cspp.ro

[5] www.sfin.ro

face enormous pressure to face the needs of an aging population.

The public pension system in Romania is an inefficient investment system because the contributions paid by employees to social security are paid in a short time to pensioners without having the possibility to be invested.

Romania unlike Hungary, which introduced the private pension previously (see table no. 4) faces significant demographic challenges, Romania's population will be reduced by a quarter by 2050 from 21.3 million in 2008 to15.9 million in 2050. Romania faces also an underground economy estimated at about one to two million people who do not pay contributions, and who therefore will achieve a low pension level or will not get a pension on retirement. In conclusion we can say that the Hungarian pension system is more adapted to the economic, social realities and the changing needs of the individuals while Romania is forced to turn its attention to increasing the employment of the active population and in particular of the older people by using an active strategy in order to encourage employers to recruit and retain workers over 40 and those who are approaching retirement age.

Table no. 1

The period of time when private pension systems were introduced

State	Pillar II	Pillar III
Hungary	1998	1994
Romania	2008	2007

Source: www.globalpensions.com

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