

## **THE COST OF POPULATION AGING ON THE PUBLIC PENSION SYSTEM IN ROMANIA**

**DANIEL NICOLAE MILITARU \***

**ABSTRACT:** *This paper analyses the interrelationships between population aging and the public pension system in Romania and the economic impact of population aging on public finances. The pension reform is the only solution for the pension systems to deal with the challenges of demographic change. The paper analyses the main challenges of the pension systems at the European level: population ageing, the reduction of the active population, the consequences of the economic and financial crisis, the trends in the labour market, in order to deliver viable solutions to social decision makers for creating a suitable and sustainable pension system that should allow citizens to maintain a certain standard of living after retirement. Also, due to the structural changes that have occurred, mainly the transition to funded pension systems that involve for individuals to take more risks, we will analyse if this gradual transition to the private pension systems is the key to the sustainability of pension systems in Europe.*

**KEY WORDS:** *public pension system; population aging pension reform; demographic crisis.*

**JEL CLASSIFICATION:** *H55; H75.*

### **1. INTRODUCTION**

Considering the ample debate at EU level about the impact of population aging on pension systems in Europe, this paper focuses its attention on the demographic trends with major impact on pension systems, namely, on population aging, low fertility rates, mortality and the increase in longevity. The analysis is made both at global and national levels and it is based on data supplied by the National Institute of Statistics, Eurostat and the World Bank.

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\* *Ph.D. Student , University of Craiova, Romania, [militarunicolaedaniel@yahoo.com](mailto:militarunicolaedaniel@yahoo.com)*

The methodology used in this paper consists of analyzing data correlation in order to assess the impact of aging on public pension system in Romania and to offer solutions for ensuring long-term sustainability of the pension system.

Starting from the premise that pension systems are designed to ensure the financial security of people reached retirement age, this paper assesses and analyses in detail the main lines of action to reform the public pension system. Although this aging process was envisaged long ago, Romania has failed to reform the public pension system in order to cope with the demographic trends recorded worldwide and especially in the European Union.

If the Romanian government will not respond with appropriate long term reforms of the registered pension system inefficiencies in the social security budget the fiscal situation will further aggravate and country's growth prospects will slow down by more creating a pressure on public finances.

Considering that social policies are expected to remain unchanged, population aging can slow down GDP growth per capita by increasing public support for seniors through grant pensions and other social benefits.

Social policy priorities, the content and the effects of these actions must be consistent with the national circumstances and must have as main target reducing the imbalances in the public pension system and the necessity to ensure its sustainability.

## **2. THE ANALYSIS**

The public pension system in our country is a redistributive one and it is affected by the low level of labor employment and therefore by the low level of contributions to the social insurance budget.

From an economic point of view aging population recorded a number of costs at both microeconomic and macroeconomic and makes economists to be more interested in quantifying the costs of aging on public finances.

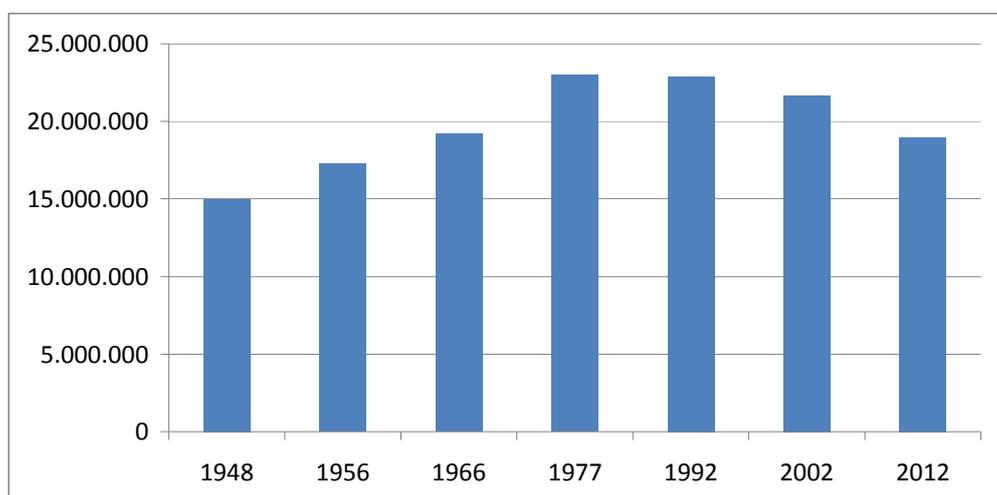
Considering the fact that pensions are the main source of income for the elderly, the redistribution principle, on which the public pension system is based, finds itself in the position of not being able to fulfill the inter generational promise, namely that young people who work pay for current retirees.

Retirement at a more advanced age can be a viable solution to this inter generation problem and may increase future levels of replacement rates. Otherwise we can consider the raise of the retirement age is a necessity.

Population aging correlated to increased longevity will have negative economic consequences on public finances and will reduce growth potential at the same time. However correlated with the current economic and financial crisis, it prevents pension systems to fulfill intergenerational promises.

Starting from the idea that current retirees are entitled to a decent living, the reform, that our pension system must go through, focuses on changing Romanians' mentality, enhancing their economic education in the spirit of saving for themselves and for their future to the sole purpose of being able to make a decent living after reaching retirement age.

Romania's stable population reached 19,043,767 people in 2012 according to the latest data provided by the National Institute of Statistics, reaching the lowest recorded level in our country in the last 40 years.



Source: Data provided by the National Institute of Statistics

**Figure 1. Stable population in Romania during 1948-2012**

Romania's active population is at present of 9,759,000 persons, of which 9,019,000 are people employed in the workforce and the remaining 740,000 are unemployed, which means that we have a dependency ratio of inactive persons per 1000 % of 1368 active people. In the first quarter of 2012 the active population aged 15-64 years recorded an employment rate of 58.0%.

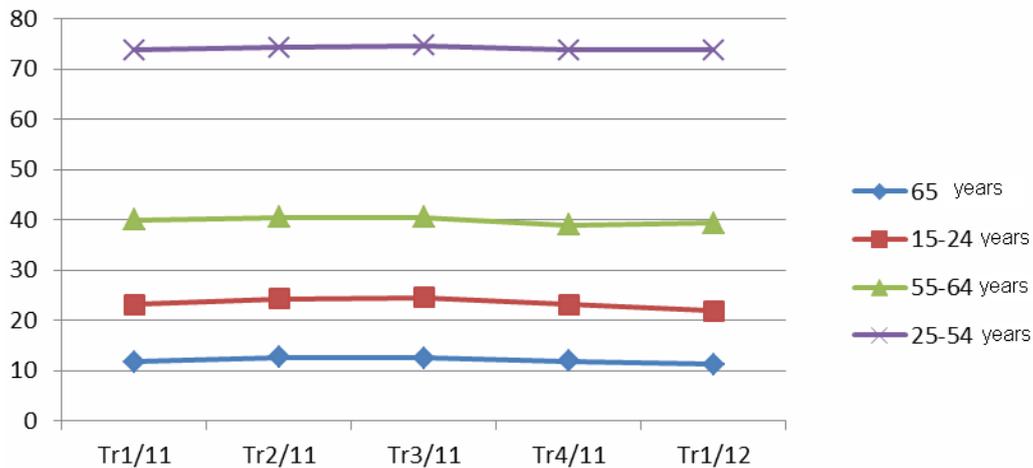
In Romania there are 7.087 million of households where 18.878 million people are established, meaning a rate of 99.1% of the population. Thus, each household shelters 2.66 people (266 people from 100 households). The remaining 165,000 were registered in collective living spaces or are homeless people.

In contrast, the lowest share of households in urban areas, are at Giurgiu county (28.4%), Dambovița (30.7%) and Teleorman (32.1%). Average household size is smaller in urban areas (2.53 persons / household) than in rural areas (2.83 persons / household) (journal. ro.).

These demographic changes will have a devastating impact on public finances in the next period if the current social protection policies are not reformed so as to reflect these demographic changes. The share of pension expenditure in GDP may exceed 16% in 2060, which places Romania among the countries with the highest spending on pensions in GDP in the European Union.

The impact of aging on public pension system has the effect of increasing state public pension expenditure to 16% by 2060. The decline in economic growth, the serious lack of vital financial resources in the national budget, the weak financial

stability, population aging and low employment intensifies the urgent need to adjust retirement practices and security pension rights.



Source: Data provided by the National Institute of Statistics

**Figure 2. The evolution of employment rate (population aged over 15)**

Romania's population continues to grow along with increasing life expectancy, Romania's population will reach 16 millions with a dependency ratio of those assets that support will fall to 20.8 million people in 2020 to 18.1 million in 2050 and 16,9 million in 2060, Romania is the fourth country in the European Union dramatic population declines (-21%) after Bulgaria (-28.2%), Letonia (-25.9%) and Lituania (-24, 3%).

**Table. 1 Fertility rates in Romania during 1980 -2060**

Year	Fertility rate
1980	2,44
1990	1,84
2000	1,39
2006	1,31
2008	1,32
2010	1,33
2020	1,37
2030	1,41
2040	1,44
2050	1,48
2060	1,52

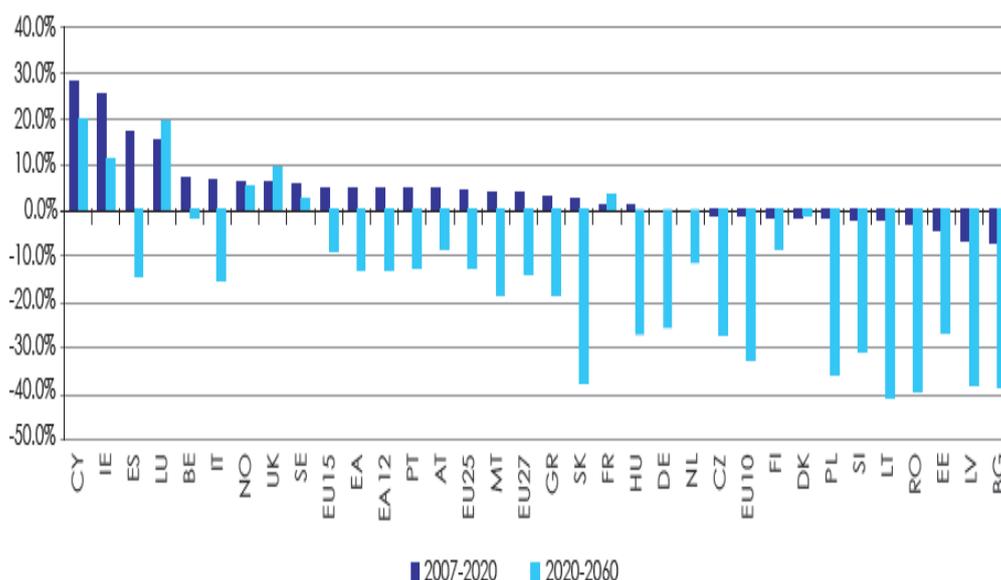
Source: Data provided by the Eurostat and Europop 2008

We must consider two directions that need to be analysed in order to solve the problem of aging, meaning the decreasing fertility rates and the increasing in longevity. The decreasing fertility rate is the main factor of aging resulting in a small number of births and an increasing number of elderly.

Beginning with the objective of pension systems which is to provide some financial security for older people, governments need to better manage these demographic trends in order to achieve this goal because they can cause loss of equity and efficiency in the system.

Population aging has a strong negative effect on economic growth according to the GDP forecast models made by Malmberg and Lindh who demonstrated that aging has a negative correlation with GDP growth per capita (Malmberg & Lindh, 2004).

This means that in countries where the aging process is very advanced, there will automatically be recorded higher costs with the pensions for the elderly, by diminishing the available resources at the same time with reducing the main factor of economic growth, labor productivity.



Source: [http://ec.europa.eu/economy\\_finance/publications/publication13782\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication13782_en.pdf)

Figure 3. Percentage change of persons aged 15 to 64 years

The aging structure of the population in our society can influence consumption and the savings by the fact that people over the age of 60 record minus savings as they use everything they have to fill the gap in their lower pensions. The more generous the pension systems is, by providing a greater benefit compared to the contributions paid, the more attractive it will be to young people encouraging them to work until retirement age, while the elderly can afford to accumulate wealth (Mirescu, 2011).

### 3. CONCLUSIONS

The goal of pensions policy is to build a financially sustainable system because only in this way it can be achieved, meaning by providing adequate income to pensioners, ensuring them a decent living and economic independence.

In order to succeed, there must be a balance between the activities carried out during working age and the inactive retirement years, and also a balance regarding the participation in private pension systems.

Among the measures placed on the public agenda of the European social actors we can include:

- Encouraging people who want to stay active and reached retirement age by extending their professional active life;
- Providing certain tax facilities to employers who maintain in employment persons who have reached retirement age;
- The implementation of the necessary measures in order to ensure that citizens have access to a higher lifelong education and training;
- Through the social policy reforms there must be reduced or eliminate the possibility of public pension systems' taxpayers to take advantage of unjustified early retirement schemes or any other way of early leaving the employment pool;
- All measures of social policy reform must have as starting point the adjustment of pension age to citizens' life expectancy;
- The state has to promote the development of additional saving systems through which citizens can get a pension supplement to the public pension.

The main direction of the reforms implemented in our country, the changing of the retirement age by increasing it, has reduced for the moment the impact generated by population aging on its own pension system, but in Europe, it is expected to continue the increase in spending also generated by the demographic phenomenon, with up to 5 percent of GDP.

The dynamics of capital accumulation and the sustainability of the pension system depends largely on the openness of the economy. The European economies are not isolated from each other nor of the world.

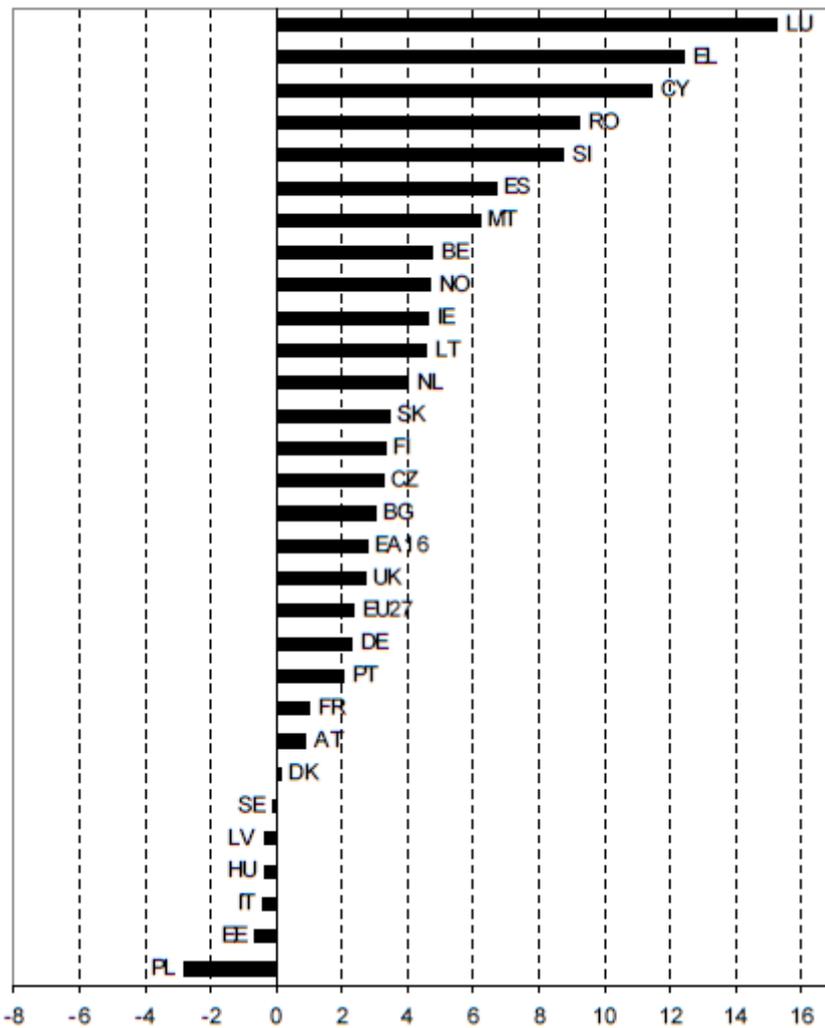
Therefore, even slight differences in their pension schemes, coupled with a severe aging population will inevitably increase the financial flows between these countries and will bring modifications regarding the accumulation of the fixed capital.

Thus the nature of the financial environment will play a crucial role for the European economies in the process of adapting to these phenomena and implementing their reforms. So, an increased regulation of the financial markets is also a necessity.

I believe that to deal with this situation we should consider the changes in the consumption habits for all ages and to give more importance to cover the essential costs for a decent life. It seems that population decline is a greater danger to the world economy than the current recession.

So, it is necessary to develop and implement regulatory strategies to support pensions on long-term.

I think that in this context we need to give a special importance to the supervision and coordination of pension policies across Europe.



Source: [http://ec.europa.eu/economy\\_finance/publications/publication13782\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication13782_en.pdf)

**Figure 4. Expenditures for pensions payment in GDP (%)**

In addition to these measures, older workers should be given other opportunities in the labor market:

- The access to specialized services of placement on labor market for older people;
- The state has to create and offer social benefits and tax systems that should facilitate the employment of older workforce;
- Combating age discrimination;
- Ensuring income security in old age;

- Promoting an active life in society by helping the elderly to participate to society development;
- As a result of demographic changes and the costs generated by them, there is necessary a further reform of the pension system by raising the retirement age, by giving up the possibility of early retirement, by providing tax and social facilities to employers who keep and hire older people, through the development of labor market insertion programs for this category of people and by promoting the concepts of active life and active aging through programs of lifelong learning and retraining leading to a late withdrawal from work.

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