CONTRACTING OUT THE PENSIONS SYSTEM IN ROMANIA

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Abstract:
The economic crisis, austerity measures and the new challenges of the 21st century have determined governments to adopt new tools of public actions in order to strengthen the policy capacity. A new paradigm was born, and its main feature is collaboration among government's level (ministries) and between government and private sector. It brings new tools of public policy among others, and contracting out used by policymakers at various stages of public policy cycle and for different sets of reasons. This paper explores theoretically how this new approach strengthens the public policy capacity and provides evidence occurring in Romanian government practice. While, Romania has a legalistic, a normative approach of policy processes and street-level bureaucracies are guided by managerial targets and law, it starts to contract out some tasks that traditionally belong to government. The main scientific objective of this paper is to contribute an overall understanding of contracting out in public policy-making in Romania, particular in pensions system, focused on the rationality of introducing that.From a methodological standpoint, the paper relies on comprehensive and systematic search of the literature and document analysis (among others Annual Reports, authorities' data, resume, obtained by using free accession to information) and statistics data processing (quantitative and qualitative interpretation of data from National Institute of Statistics).

Keywords: social policy, contracting out, rationality, pensions' system

1. Introduction

The failure of policy at implementation stage raised many question on management of public authorities regarding the execution and formulation of public policies. Moreover, the economic recession constrained the Romanian government to initiate in 2010 a set of austerity measures, aimed in principal at reducing the public spending. These measures affected all the components of the social protection sector. In this context, public policy studies have developed a standard list of key requirements for the successful implementation of policy (Chalmers and Davis, 2001, p. 74). Same times, for doing it, governments choose to implement policy and deliver services through contracted actors. A new paradigm was born, and its main feature is collaboration among government's level (ministries) and between government and private sector. It brings new tools of public policy among others, and contracting out used by policymakers at various stages of public policy cycle and for different sets of reasons.

According to Bridgman and Davis (2000, p. 119) a contract is "a legal agreement to regulate the private provision of government services'". A different terminology is used in different countries for contracting out, including competitive tendering, contracting, and outsourcing. Contracting out is the practice whereby governments contract with private sector providers for the provision of services to government ministries and agencies, or directly to citizens on behalf of the government (OECD, 2009, p. 81). In general, functions such as construction of infrastructure, waste collection, cleaning have been contracted out by governments with long time ago, but the “new contractualism” extend the practice to an array of new policy and service delivery subject (Chalmers and Davis, 2001, p. 75), including also, social policy. In this area, pension system represents a new challenge for governments. Almost all countries from Central and Eastern Europe have reformed their pension systems in the past two decades as a response to the population aging and fiscal pressures.

Perspectives on the appropriate level of state intervention in the pension system vary widely. According to one, governments should provide the basic minimum, but in the same time should leave choice to individuals who will look after themselves. Others believe that the state should enable everyone to build up a decent retirement income (Pensions Commission, 2005, p. 28).

2. Theoretical background and research questions

In the last decades, the world has been transformed, the public sector no longer dominates policy deliver as it once did. The accession to the EU and enlargement of the European integration process have determined profound reforms in the European countries area, reforms gravitating around the objective nucleus represented by observing the fundamental principles of democracy, separation of powers and respect for the rule of law (Matei, Matei, Stoian, Dogaru, 2011, p. 30). A new approach was born and contracting and privatization have reshaped the organizational landscape, creating new, mixed forms of provision and complex delivery arrangements. Today, policy delivery occurs not only through public bureaucracies, but also through non-profit organizations, for profit firms, and mixed public - private arrangements (Brodkin, 2012, p. 5). So, before specifying the data and the results, it is worthwhile to discuss some theoretical issues concerning the contracting out decision.

Contracting has been established as a standard form of policy delivery, as an instrument with few limits, preferable in most circumstances to traditional public bureaucracy. Ones of contracting out scholars (Webster and Harding, 2000, p. 10) argue that the change ensure the efficiency gains arising from better work practice and more effective use of capital. Contracting out an activity does not diminish, in any way, the responsibility of the organisation for the performance of that service (OECD, 1997, p. 3). In Romania, as in many countries social services that traditionally have been provided by the public sector are being contracted out to private providers. So, the first research question arises is: *which is the legal and institutional framework for contracting out, as public policy tools in Romania?*

In this context, policy makers can use contracting out at various stages of the public policy process and for different sets of reasons. Having a wide range of tools for public policy implementation and delivery, public bodies and private companies are permanently confronted with the decision of whether the should “make” or “buy”. There are a broad literature that addresses the reasons to contract out the service delivery to the private sector, and the benefits of contracting out. Different theories are used to explain the considerations for contracting out. For example, public choice theory focuses on the public organisation and the behaviour of managers, and is useful to investigate the reasons for that governments transfer a part of their implementation power to the private sector. On the other hand, transaction costs theory is especially useful for understanding the reasons why certain activities are contracted out, while other services are provided by government itself (Wassenaar, Groot and Gradus, 2010, p. 3). The main reasons for contracting out found in the literature filed are: efficiency, quality of external service provision, public private ideology (Bel et al., 2007, pp. 507-515; Bel and Fageda, 2007, pp. 517-534), costs of assets (Brown and Potoski, 2005: 326 - 351), availability of alternatives, available quantity of personnel (Wassenaar et al., 2010, pp. 617-636). Despite the vast literature on this topic, taking account the reforms regarding the policy capacity of Central and Eastern Europe states, a comprehensive explanation for identifying the Romania motives for contracting out it is necessary. The second question drawn is: *which are the rationalities of Romania to contract out the implementation of some policies?*

We are witness to evolutions of the public sector in the context of changing of states' roles and institutional structures of the central public administrations, changes of the ratio governors and governed, diversification of the actors involved in policy making and enlargement of the area of public action wherever there is a public need, and, on the other hand, by the effects of decentralization, delegation, privatization etc. (Matei, 2007; Matei, 2008, p. 1). Increased "contracting out, privatization" (Ebbinghaus, 2007; Bennmarker, Grönqvist, Öckert, 2012; Petersen, Hjelmar, Vrangbæk, la Cour, 2012) of old age income security has been advocated as a solution to the sustainability problems of public pension systems, yet private supplementary pensions can take different forms in terms of who participates, whose interests are represented and how the benefits are funded and calculated. So, another issues addressed by this paper and the scholars are the *advantages of contracting out*. The main argument, in this sense, carried out in fact that private contractors possess the advantage over public organisations, because they have a stronger focus on outcomes. The constraints are imposed by the necessity to earn at least an average return on investment, a more flexible labour force, fewer procedural constraints and more powerful structure of incentives for managers (Hart et al., 1997, pp. 1127–1161; Shleifer, 1998, pp. 143-150). Private pension benefits tend to neglect intra- and intergenerational solidarity typical of public programmes, though this depends on the governance mode in private pensions as they are shaped by state and non-state actors at national, sector- or firm level.

3. The overall research design: The private pension system in Romania

3.1. Research methodology

This research used different instruments in order to gather as much and detailed information as possible on the theory and on the practice of contracting out in Romania. Firstly, the paper relies on a comprehensive and systematic search of the literature. The author reviewed a part of the vast amount studies on contracting out issue in other developing or less developing countries and looked for readily available materials on the internet. A secondary source of search has been represented by document analysis based on Annual Reports, authorities' data, resume, obtained by using free accession to information. Using statistics data processing, particularly quantitative and qualitative interpretation of data from National Institute of Statistics has been necessary in order to draw relevant and coherent conclusions. The study presents the contents and recent development of social policies in Romania and analyses the main trends in the private pensions system.

3.2. The sample

The sample used for research has been represented by pension system from Romania. The attention was focused on reforms made by Romania for enhanced the policy capacity, especially the implementation of public policy and services delivery. Contracting out as policy tool got a special investigation, and the unity of analysis was "the private pension system". In Romania, the private pension system includes two components, the 2nd pillar based on a defined contribution scheme and 3rd pillar based on voluntary contribution, both managed by private companies. Because the enrolment in the 3rd pillar is voluntary, in this paper the attention is focused on 2nd pillar where the enrolment is mandatory. The analysis is based on data published after the starting of this new pillar until now, means 2008-2013 periods.

4. Data analysis

4.1. Legal and institutional framework

Since 1990s, there were several attempts to reform the Romanian pension system. A first law on the pension system was approved in 2000, Law no 19/2000 on public pension system and other social insurance rights. Since that, a number of modifying and completing activities took place, the last law approved being in 2010, Law no 263 on unitary public pension system that repeals the law no. 19/2000. Regulations introduced with the entry into force of the law on pension represented the framework for pensions' system reform and for applying the European Union's rules (EEC Regulation no. 1408/1971, Regulation EEC no. 574/1972, Stegăroiu, 2007). Pension systems vary extensively across Member States and there are significant differences not only in their structure but also in the terminology used. At present, depending on the state reforms of their pension in the EU there are four categories of state (PPSSP, 2010; Allianz Global Investors AG, 2007, p. 80): (1) with private pension systems less developed and that are not intending to alter the existing situation, although it is a trend in this regard: Spain France; (2) states with evolved private pension systems that have always depended on these systems: Denmark, Netherlands, UK; (3) with public pension systems, "a pay as you go", reformed by introducing Pillar II - mandatory pillar, financed from contributions in completing the unfunded public system: Bulgaria, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia, Sweden; (4) traditional unfunded social insurance Systems, sometimes with a minimum level of social insurance that switched to a private pension: Germany, Austria and Italy.

For this study the modifying made in 2004, respectively in 2006 is very important because paved the away for introducing a mandatory second pillar, and a voluntary pension pillar. Although the implementation was delayed, a new policy tool appears available, contracting out. This instrument is used for manage these two new pillars. In 2007, the voluntary pillar became operational, and one year later (2008) the mandatory pillar started running. Thus, at the time being, the Romanian system of pension has three components: (1) pillar I – state pension; (2) pillar II – mandatory pension with private management and (3) pillar III – voluntary pension with private management, and (4) occupational pensions. OECD has prepared a classification of public pension plans and private pension plans. According to the OECD classification, they are defined as follows: "public pension plans are social security and similar statutory programmes administered by the general government (that is central, state, and local governments, as well as other public sector bodies such as social security institutions). Private pension plans are administered by an institution other than general government" (DGIP, 2011).

The model of private pensions from Romania is based on a model tested and recommended by World Bank. This complex pension system attempts to remove the inherent problems of a system with a unique pillar and to support the development of a mechanism which can ensure more equitable distributions and lower costs. The aim of the second pillar, mentioned by law no. 411/2004 is "ensuring a private pension which can supplement the state pension, on collecting and investing by specialized private companies, in benefit of stakeholders, a part of individual contribution to social insurance. The contribution is mandatory for people under 35 years old and voluntary for the

36 to 45 age cohort. First contribution was 2% of the gross salary stated on the work card, and will grow to 6% until 2016. It is worth to mention that 2% percentage is not an additional one to the contribution to public pension, but from this a part (2%) go to private company chose by employee. For 2013, the rate of contribution to private pension funds is 4% (art. 18 par. (2) of Law no. 6/2013 on State Social Insurance Budget 2013).

Regarding the institutional framework, in Romania we see the following situation: (a) public pension system is done by Ministry of Labour, Family, Social Protection and Elderly and National House of Public Pensions. The National House of Public Pensions has been established through Law no. 263/2010 on unitary public pension system and working in accordance with its provisions. (b) mandatory private pension system (pillar II) has nine private administrators, namely: AEGON, ALICO, Allianz-Tiriac, BCR, BRD, EUREKO, GENERALI, ING. These institutions get the contribution from the participants in privately administrated pensions' funds, invest the financial resources, calculate and pay the private pensions. Also, the reform created the Private Pension System Supervisory Commission (PPSSP), re-called in 2013 Authority of Financial Supervision by Law no. 113/2013, and the National Committee for Financial Stability. (c) voluntary private pension system (pillar III) is managed by Allianz -Tiriac, APF, BCR, BRD, EUREKO, GENERALI, ING and S.A.I. RAIFFEISEN ASSET MANAGEMENT S.A.

The institutional and legislative approach of the public policies is based, on one side, on the institutional management, by using instruments such as planning of the resources or the development of efficient institutional models, borrowing from the private sector expertise, the process of strategic planning, and on the other, the adoption, modernization and actualization of the necessary legislative framework (Matei, 2009, p. 190).

4.2. Rationalities for contracting out the pensions

Pension systems are always closely related to the economy. The economic, social and demographic factors in the context of globalization (World Bank, 2010) and the deficiencies facing Romanian public pensions' system require new tools for managing the social policies. One of these is contracting out that helps policy makers to answer to the following issues (Stegăroiu, Stegăroiu, 2010, p. 50): (a) mismanagement of the social security funds – public pension system is unable to provide a higher minimum income for the vast majority of existing pensioners; (b) a system based on distributive pay-as-you-go (PAYG) scheme - employees pay contributions directly out of their salaries. Returns depend on the number of employees, the wage level and the contribution rate. The principle of solidarity between generations is not resistant to the current unfavourable demographic changes. (c) inequity in calculating and determining the nature of pension benefits due to the occupational pensions which led to a sharp increasing of pension budget' deficit.

According to other view (CNPV, 2009), Romania facing with: (a) crucial problems of structure – decreasing the employees number, those who sustain the pension system through contributions on pay-as-you-go principles; (b) additional pressures determined by the later introduction of private system (especially the second pillar); (c) large weighting of contributions from employees' income and employers' expenditures to the pension fund; (d) great social pressures to raise the average pension to 45.0% from average gross wage salary in national economy; (e) major social complaints caused by inequity determined by the occupational pensions of parliaments, magistrates and others.

Also, as many others country, Romania has to face the challenges of population ageing and the decline in number of contributors to the public pension system compared to the number of beneficiaries. According to the demographic forecasts for Romania, issued by Eurostat, it maintains the accelerated aging and a reduction by 37% of the population aged 20 to 65 years compared with the 20% of the total population of Romania in the period 2010 - 2061. It expects the population over 65 years to grow about 1.9 times, and the population between 20 - 55 years to get to half during this period (Militaru, 2012, p. 2). In response to population ageing many more countries, including Romania, have looked for new policy instruments. Some countries have expanded the role of existing private schemes, while others introduced new elements of pre-funded, privately managed pensions into their pension systems. Another problem that Romanian public authorities must to take into consideration when contracting out is more people withdrawn from the labour market before the statutory retirement age. Unfortunately, the statutory retirement age is planned to increase in the next period (European Commission, 2012).

Therefore, the impossibility of public pension system to ensure the efficiency and effectiveness of social policies led to a new vision on social policies, and a reform strategy. In this context, a radical reform step and has been inspired by the World Bank model of pension reform, in hopes that a fully funded second pillar will help diversify retirement income and allow more people to participate in capital markets.

As, a private pension insurance with a private system of management, pillar II supplemented the pension granted by the public sector, based on collecting and investing in the benefit of the participants. The implementation of this pillar does not involve any additional cost for any employee for any organization. Besides the common rationale for contracting out, results in cost savings and efficiency gains, the Romanian private pension system represents a step towards a balanced pension system which will results in (CNPV, 2009, p. 91): (a) removing the pressure on the state social security budget; (b) stimulating the economic growth by investing the contributions in private pension funds; (c) developing the capital market, because the assets of private pension funds can support both capital market development and the investment projects launched by state or private sector, through market tools.

Contracting out the pension system has typically happened in order either to improve the overall adequacy of pension provision or to compensate for reductions in the future replacement rates of public schemes resulting from reforms. Other reasons cite by Member States (European Commission, 2010, pp. 5-9) are moving to greater reliance on private funding in their systems include wishes to diversify provision, boost choice, improve transparency and foster greater individual responsibility. In the European realm of reform and modernization of pension systems, Romania chose to implement a pension system with several components, based on diversity of sources for getting pensions, including contracting out. The main reason has been ensuring the financial security of elderly persons, reducing the risks caused by the old age income replacement.

In parallel, as a policy for increasing the number of contributors, a new Labour Code was passed by the parliament, which institutes higher flexibility on the labour market. Overall, the recent reforms initiated in the field of social protection are both necessary and urgent (Zaman, 2011, p. 3).

4.3. Romanian private pension system in key figures

The social model, on one hand, and the culture of savings, on the other hand, determines the role and place of private pensions in each country. Over time, since 2008 till 2013, the total net of assets managed by private entities has grown steadily. The private pensions complement the public system for the purpose of providing the future retirees with an appropriate replacement income. The reform of the pensions system born in a bad period of economic development should facing with the global economic crisis. In this context, the main indicators, number of participants and net assets underwent light changes in 2009. During this year the contribution to private system does not increased according to the legal provisions, but on the contrary remained the same (2%). It is worth to mention that 2010 represents another challenge for private pensions system due to the austerity measures took by the Romanian government. To alleviate the crisis, the government increased the VAT from 19% to 24% and cut the salaries from budget sector with 25%.

All of this affected the national economy and the also the private pensions system. The impact of the financial crisis on private pensions and financial restrictions of the state have strengthened the necessity of developing sustainable, combined/multi-tiered pension systems, creating financial balance for each component, as well as assuring medium and long term individual sustainability. At a glance on the main indicators of the 2nd pillar of private system we notice (PPSSP, 2007-2013). I used national currency (leul) for net assets and data from Quarterly Reports, March special edition for 2013 reflections.

2008 - reflections

- 4.53 million members;
- 831.9 million net assets;
- 14 pensions funds/administrators;
- 0.16% of GDP.

2009 - reflections

- 4.91 million members;
- 2,384.4 million net assets;
- 12 pensions funds/administrators;
- 0.49% of GDP.

2010 - reflections

- 5.19 million members;
- 4,331.9 million net assets;
- 9 pensions funds/administrators;
- 0.84% of GDP.

2011 - reflections

- 5.52 million members;
- 6,416.3 million net assets;
- 9 pensions funds/administrators;
- 1.17% of GDP.

2012 - reflections

- 5.77 million members;
- 9,637.2 million net assets;
- 9 pensions funds/administrators;
- 1.64% of GDP.

2013 - reflections

- 5.86 million members;
- 10,543.6 million net assets;
- 9 pensions funds/administrators;
- unknown% of GDP.

Considering these elements the analyses allow for a series of conclusions regarding the private pension system. The total net value of the assets is recording a steady increase over the last years, a much steeper growth recorded in 2011-2012 period. This tendency illustrates the overall expansion of the private pension in Romania. Concerning the number of participants, 5.77 million of persons have been registered in pillar II at the end of 2012, with 4.65% more then 2011. In March 2013, in the 2nd pillar it found 5.86 million members.

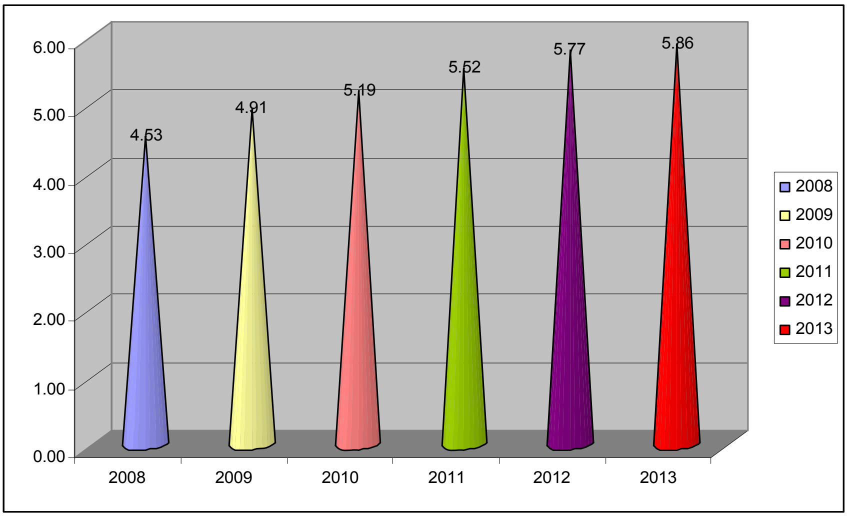

Chart 1. Number of members – 2nd pillar
Source: author based on data PPSSP data

The participants' number increased monthly, but the registered values were between 0.62% and 0.22%. The balance of the new participants to the second pillar has been random assigned. In regards to the distribution of participants by gender, it has remained relatively constant, in December 2012, the ratio female/male was 48% to 52%, but in what concerns the age distribution it is important to note that 55% of members aged fewer than 35, and a 45% has over 35 years old, while for the last category (36-45 years old) the participation to the 2nd pillar is voluntary. These changes are reflecting in the following figures:

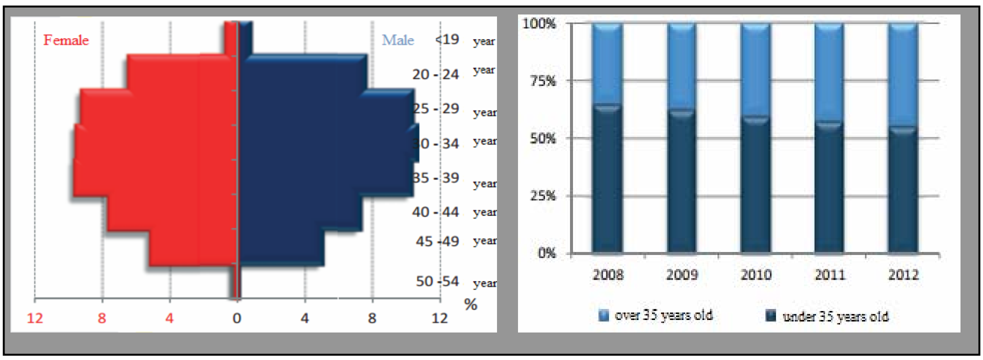

Figure 1. Structure of participants by gender and age – 2nd pillar
Source: PPSSP, 2012, p. 79

Also, the above figures present a comparative overview on aging distribution in private pension funds (pillar II), based on it can drawn the conclusion that no major changes occurred since the implementation of the mandatory private pension system in Romania. Turned back to the contributions and assets, the administrators have to respect the provisions of the PPSSP's norms, namely:

Norm no. 3/2009 on investments of private pension funds and the investing activity, and Norm no. 4/2009 on investments of voluntary pension funds and investing activity. They are based on the Law no. 411/2004 for the mandatory pension funds and on the Law no. 204/2006 for the voluntary schemes and provide a further framework for the private pension funds investment procedure. These norms aim at providing an efficient and equitable correlation between risk and outturn.

Thus, according to article no. 14 (of both norms), the fund manager can invest the fund's assets on the monetary and financial markets, limited by certain provisions, such as (Şeitan, Artenei and Nedu, 2012; EIR, 2012): (a) monetary market instruments: 20%; (b) state bonds RO, UE or SEE: 70%; (c) bonds and other transferable securities issued by the local public administration in RO, EU or EEA, traded on a regulated market in RO, EU or EEA: 30%; (d) securities traded on a regulated market in RO, EU or EEA : 50%; (e) bonds issued by third-party states, traded on a regulated market in RO, EU or EEA : 15%; (f) bonds and other transferable securities issued by the local public administration in third-party states, traded on a regulated market in RO, EU or EEA : 10%; (g) bonds issued by Nongovernmental Foreign Bodies, traded on a regulated market in RO, EU or EEA : 5%; (h) undertakings for Collective Investment in Transferable Securities - UCITS, including ETF in RO, EU or EEA : 5%**;** (i) private equity: only for voluntary pension funds: 5%**;** (j) bonds issued by the World Bank, the European Bank for Reconstruction and Development and the European Investment Bank, traded on a regulated market in RO, EU or EEA : 15%.

At the start of its implementation the contribution was 2% of the base, but at the time being the contribution for 2nd pillar is 4% and will grow by 0.5% per year so that in 2016 the contribution will represent 6%. In spite of the overall positive situation of the private pension market, the reform is still underway and neither did the crisis affect to a considerable extent the benefits paid from private pension funds. So, looking at the EU level, Romania has to coordinate its national policies and to try achieving the objectives set up by Europe 2020 Strategy. Instruments from private sector, such as contracting out, but also from other theories, as rational choice helps policymakers to understand better how economic, social and political background is changing and how the public policies must evolve for adapting themselves to the changing needs and to the change of society. The premises of these theories have subtended the emergence of a new model of public policy analysis focusing on the formulation and implementation stage (Matei, Dogaru, 2012, p. 10).

5. Concluding summary

Demographic chances over the last decades, such as aging population, decreasing birth rates and financial pressures on pension systems represents one of the greatest challenges of the XXI century and sensitive points on all of policymakers' agenda. Aside from the economic consequences, due to increasing unemployment, public budget deficits and low economic growth, population pay highest costs for policymakers' decisions, namely social consequences. All of these require states to rebalance revenues and expenditures in social policy and to rethink the policy tools and the policy-making process.The recent global crisis warned the policymakers that they have to be innovative for obtaining efficiency and effectiveness. The pension system is only one milestone of the policy process' reforms. Partnerships between state and non-state actors are also required in others policy area.

Analysing the filed of literature and strategic documents it can be draw that Romania, together with the other EU Member States, continues the series of transition and accession reforms, associated in the last years with measures for overcoming the crisis and reviving the social security system. Using contracting out in pension system came as an answer to the problems of the public pensions' system. The private pension sector in Romania is relatively new, its current form is the result of a process of evolution started in 2000, with more visible outcome from 2007, respectively 2008. The private pension system attempts to support the development of a mechanism which can ensure more equitable distributions and lower costs. In this context, it has been set up and strengthened the legal framework for organising and functioning of the entities on private pension field, as well as for cautious supervision of the management of these funds. It is a complementary system to the public one and is based on accumulation of contributions and their capitalization on the financial markets. The model implemented by Romania is not a new one, but it is the World Bank model. The World Bank model is a multi - tiered system, applied with few differences, but on the same principle across 30 countries from worldwide, especially from Central and South America and Central and Eastern Europe.

In what concerns the factors that triggered the reshaping of the national pension system they are similar to those from other countries and outlined above in this paper. It is important to remark the outcomes and efforts of private pension system for economic development, but the policymakers have to take into consideration the fact that reforming and building up a sustainable and adequate policy-making process is in charge of the state, private national and international market operators, non-governmental organisations and not at least of the civil society as whole. So, just putting together their material resources and knowledge will face the challenges for governance, particularly for policies.

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