The evolution of social security revenue in the new European Union member countries

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Abstract: *Mandatory social security contributions are one of the most important sources for the state consolidated budget. They have a strong impact on the financial balance and sustainability of each country. This paper studies the level and the evolution of this type of revenue in four new member countries of the European Union.*

In figure 1 we represented the average structure of budget revenues in several European countries during 2000-2008. Note that: in all countries under study the highest share of budget revenue is held by tax revenue, over 50% of the total budget revenue, as expected.

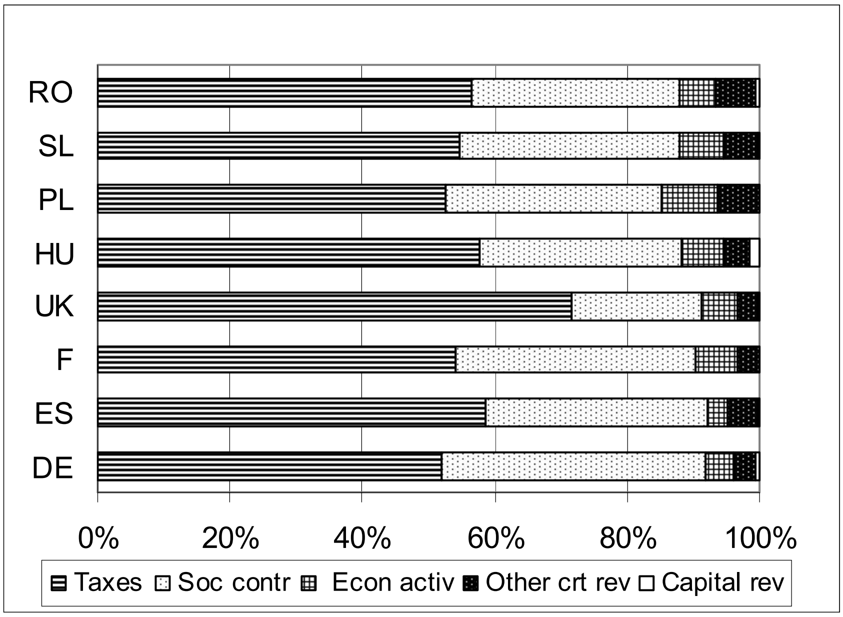

Figure 1. Average structure of budget revenues (%Total Revenues) during 2000-2008

Source: adaptation of Government finance statistics, Summary tables

Revenues from social security contributions come second in importance within budget revenues, reaching values between 30% and 39.78%. Countries with a strong economic development have developed generous social security systems that require increasingly larger resources, and that is why the share of social security revenues must be accordingly represented within the structure of government revenues. A maximum is reached by Germany (39.78%), which holds the first place when it comes to this type of revenue among all countries under study, due to the rates of compulsory social contributions which are still high in order to meet the imposed standard of a" wealthy country". It is followed by France (36.18%), another country with highly developed social policies that require appropriate revenues, and Spain (33.4%). An exception to this series is the UK, where, as widely known, contributions to compulsory social security are the lowest throughout the EU (only 19.66%), but where we also find the lowest public expenditure on social security, which makes strong proof of long-term budget sustainability.

Table 2. The evolution of social security contributions as a share of the total revenue in former communist countries **(%TR)**

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Hungary	29.67	30.78	31.45	31.30	30.73	29.91	29.54	30.41	29.93
Poland	36.27	36.82	35.28	35.04	34.83	31.49	30.50	29.75	28.99
Slovenia	33.78	34.00	33.14	33.12	33.27	33.10	33.01	32.55	33.62
Romania	28.13	34.55	33.68	30.66	30.93	31.77	31.20	31.06	31.18

Source: adaptation of Government Finance Statistics, Summary tables, Luxembourg: Office for Official Publications of the European Communities, 2006, 2009

In former communist countries the revenues from social security contributions hold a similar share (between 30-33%), but also due to other reasons besides covering the actual expenditure on social security. Here social security contributions are compensating for the absence of other reliable and consistent budget revenues, they represent (as far as the employment of the population is a normal one) a secure and constant source of revenue in addition to income taxes. However, these countries have been subject to continuous battles between employers and governments to reduce social security contributions, which raise the cost of paid work, and thus the economic development of these emerging market economies was held back. Many governments of these countries have had to raise again the rates of social security contributions after a period of reduction in order to complete the budget revenues which were beginning to drop once again. The phenomenon was accentuated during the process of restructuring former communist enterprises (in the mid 90s), when rising unemployment and reduced social security contributions revenue caused major imbalances to the government social security budgets. In order to cover the costs of social security there had to be made significant transfers from the central government budgets to social security budgets. Then, along with economic stabilization, the rates of mandatory social security were gradually lowered to stimulate employment and economic growth. Around the beginning of 2000, the level of these revenues was low in most cases. In what concerns the four countries under study, the phenomena governing the evolution of these revenues are different: their evolution in Romania and Slovenia has similar explanations, both somehow following the economic and fiscal development in these countries. However, Poland and Hungary are the initiators of new social security systems throughout the EU, being the first ones to implement the generalized mandatory private social security system guaranteed by the state, also called *Pension Pillar II*.

In 1999, **Poland** was one of the first European countries to implement the reform of the pension system, introducing an Open Pension Fund, based on private capital investment schemes besides the government social security system, the so-called Pension Pillar II. This has greatly influenced the country's deficit and public debt in the following years. The result consisted in the transfer of a certain amount of mandatory social security contributions to the Social Security Fund, thus lowering budget collection, and limiting the base of collection of social security contributions to 30 average salaries in the economy. These were accompanied by costs of the public debt created by these initial transfers, payment of limit old-age pensions for people made redundant in the process of privatization, and public expenditure cuts etc.

The studies undertaken at that time by Polish economists were presenting positive results of the pension reform on macroeconomic indicators. The Polish government had initially included contributions to Pension Pillar II in national statistics, obtaining a derogation period up to 2007, when the revenues corresponding to Pension Pillar II were considered as government revenues (this situation is similar to the one in Hungary, which almost simultaneously initiated the same type of reform, and also to the one in other countries, among which Romania).

Unfortunately the actual representation of the budget balance, according to EUROSTAT regulations, indicates a regression in Polish public finance in the pre-accession years, which was strongly influenced by extensive reforms in the pension system, leading to an increase of the budget deficit and implicitly of the public debt created to cover it. There was however a change in funding the debt, trying to replace as much as possible the loans from external markets with ones from the internal market in order to reduce exchange risk and provide liquidities and flexibility in public debt (by purchasing securities of higher liquidity). And here the pension reform seems to have had a favorable impact, because, according to caution regulations in the investment of contributions to Pillar II, most of the resources transferred from the public treasury to these funds are coming back as an acquisition of treasury bills, government bonds, thus providing a non-inflationary financing of the public deficit.

Hungary has implemented the pension reform since 1998, just like Poland. A large extent of personal contributions to social security (8 percent of 8.5) may be transferred to private pension funds within Pension Pillar II. Employer's contributions still remain transfers to the public pension fund.

This reform has had a strong negative impact on budget revenues in the short and medium term, because of the Public Pension Fund deficit, which is going to worsen furthermore as an expenditure on pensions to persons that are not contributing to Pension Pillar II. Since 2007, contributions to public social security have increased by 3% in order to compensate for part of the pension system deficit (leading to an increase by 0.7% of GDP of Public Pension Fund revenues), and despite these measures, social security revenues dropped again in 2008 from 30.41% to 29.3% of GDP.

In **Slovenia** the level of social security revenues has followed the most linear trend, probably due to the higher economic stability in this country, which made an effort and succeeded in meeting the criteria for joining the EMU. This country has also experienced problems related to extensive layoffs on the labor market, but knew how to pursue a more restrictive social policy, by not providing “luxury” social security to people made redundant, but trying to promote and stimulate their re-employment, in order to lower social expenditure and provide a constant decent level of the social security budget.

In 2000, **Romania** had the lowest amount of social security revenues (28% of GDP). Then, as a result of increasing rates levels, there was a sharp rise in 2001 to 34.55% of GDP, a figure close to the European average. We can not say that the evolution of social security in Romania followed a linear trend, as measures have varied according to budgetary financing needs and the pressure from employers in the economy. However, after 2001 social security revenues began to drop constantly as a measure for stimulating economic growth, hoping to increase the employment rate, which partially happened. The results of this policy were visible after 2005, when revenues started to increase due to a raise of the tax base, which is for those employed. The balance of the social security budget in Romania is still unsteady, because of the extent of social security expenditure and especially because of pensions, with a considerable impact on the sustainability of public finance in general.

In conclusion, as a result of an ageing population, social security budgets in all countries of the world will be facing galloping deficits. As public social security revenues will reduce, they will cause global destabilization in the budgets of all countries. That is why the European Commission has suggested since 2006 that each member country should examine their financial state and find alternative resources along with decreasing social security expenditure in order to ensure the sustainability of their public finance in the medium and long term.

Sources:

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