Major fiscal reforms in Romania and their impact on pensions

ESPN Flash Report 2018/26

LUANA POP AND DANIELA URSE – EUROPEAN SOCIAL POLICY NETWORK MAY 2018

In November 2017, the Romanian government adopted a fiscal legislation package that decreases the level of taxes and proposes a new configuration for social contributions (GEO 79/2017). The changes, while justified by the government for their positive impact on future pension benefits, threaten to increase the already high proportion of uninsured people and to create deeper divisions, in terms of future benefits, between various categories of workers.

LEGAL NOTICE

This document has been prepared for the European Commission. However, it reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

Description

In November 2017, the Romanian government adopted a fiscal legislation package that: a) decreases the level of taxes (the flat-rate tax of 16% was decreased to 10%); b) decreases the level of social contributions (a decrease of 2 percentage points, from 39.25% to 37.25%); c) shifts the responsibility for social contributions almost entirely to employees (employees pay 35% out of 37.25%, i.e. 94% of the total social contributions, as compared to 16.5% out of 39.25% of the gross wage payable before the reforms, i.e. 42%); d) increases the minimum insurable income for all workers (including part-time employees and the self-employed) to the level of the minimum gross wage; and e) slightly changes the enrolment conditions (by allowing the self-employed to choose their level of insurance, as long as this is above the minimum required level).

The reform was announced as a means to improve the sustainability of the pension budget by increasing the efficiency of tax collection, on the one hand, and increasing the adequacy of benefits in the long run (as pension benefits are calculated on the basis of a pension point system, which takes into account gross income), on the other hand. In addition, the government launched a public debate on a draft law (February 2018) to reinstitute the criminalisation of withdrawal or delay of social contribution transfers to the pension budget.

Taking effect in 2018, the new rules eliminate, almost entirely, the employer's share of the social contributions (employers are now responsible only for the work insurance contribution of 2.25% of the gross salary), transferring the responsibility for contributions to the employee. Therefore, the government promised to increase public sector gross wages accordingly (by approximately 20%), in order to maintain the same level of net incomes. As a consequence of the expected 20% increase of the gross salaries, the proportion of the social contribution transferred to the mandatory statutory funded scheme (5.1% in 2017) was reduced to 3.75%. According to the Ministry of Labour, this measure was adopted in order to preserve the nominal value of funds transferred to mandatory private accounts prior to the reforms (as the social contribution to the pension scheme is calculated as a percentage of the gross, and not net income).

While all these changes were presented as a guarantee to preserve the current net income of public sector employees, most employers in the private sector were reluctant to take any definite position. Many employers fear that these reforms could be retracted, thus leaving them with substantially increased labour costs.

Outlook & commentary

In fact, during the first months of 2018 many salaries in the public sector did not increase accordingly (due to a combined effect of both fiscal reforms and the new remuneration law), thus leaving employees with net incomes which were both lower and imbalanced (biased towards the pay-as-you-go component), and with lower than expected pension accruals. In the private sector, many employers tried to maintain employees' current net incomes, not by increasing their gross salaries but rather by topping up their net salaries with bonuses/ indemnities.

While the reforms may have positive effects on the collection of social contributions and on the pension budget deficit, it is uncertain whether they will have a positive impact on pension benefits (i.e. whether these will increase as a consequence of the increase in gross salaries).

But one of the most important consequences of the newly adopted fiscal measures, that will almost certainly have a negative impact on the pension system, is an increase in the uninsured working population and a deepening of the already existing (future) pension gap between workers in standard employment and those in non-standard employment (full-time employment versus part-time employment, employees versus self-employed) as well as between workers in the public and private sectors.

The fiscal reforms impose a uniform level of minimum insurable income across all employment forms, thus heavily increasing the social contribution level for part-time employees and the self-employed. First, the increase in the minimum insurable income for part-time employees to the same level as for full-time employees was justified by the government as a measure adopted to curb informal practices in the formal economy. In fact, the measure will decrease work flexibility, with a negative impact on both employees (who will experience not only a higher tax rate but also a reduced net income) and employers.

Secondly, the fiscal burden also increased significantly for the self-employed, whose minimum insurable income increased by about 30%. Even under the former regulations, the proportion of the self-employed enrolled in the public pension system varied between 5% and 10%, of which around 92% were paying social contributions at the minimum level (compared with only 17% of employees). The new measures will put additional pressure on these people, discouraging them even further from signing up to the system. In addition, the fiscal reforms have also changed the enrolment rules, as they allow the self-employed to choose an insured income level, as long as this is above the minimum insurable level. This will most probably negatively impact the future pension benefits of most of the self-employed.

Finally, a gap will open between employees in the public and private sectors, as employers look for different ways to compensate for the fiscal changes; this will have serious consequences on future benefits.

Summing up, while the positive effects on future benefits are uncertain, there is a risk that the reform will increase the number of uninsured workers (in 2016 the proportion of the total employed population who were insured was, according to the National Public Pension House, 71%, or 47% of the total potential labour force). It may also increase the gap between employees and the self-employed (of whom only 5%-10% are insured), between full-time and part-time employees (of whom, in 2017, 78% were already insured at the minimum level, compared with only 7% of full-time employees), and between employees in the public and private sectors.

Further reading

National Public Pension House, Statistical data, Pillar I: www.cnpp.ro.

Fiscal Council, 2017, Raportul anual al Consiliului Fiscal 2016 [The Annual Report of the Fiscal Council 2016], available at Consiliul Fiscal al Romaniei: http://www.consiliulfiscal.ro/RA2016roiunie2017.pdf

Governmental Ordinance No 79/2017 regarding amendments to the Law 227/2015 on the Fiscal Code.

Authors

Luana Pop and Daniela Urse (University of Bucharest)

The Flash Reports are produced by the European Social Policy Network (ESPN) established in 2014 to provide the European Commission with independent information, analysis and expertise on social policies in 35 European countries. The topics covered are identified by ESPN experts in the light of significant developments in their countries, or in some cases suggested by the Commission or the Flash Reports' editorial team (Eric Marlier, Slavina Spasova and Bart Vanhercke). The ESPN is managed by LISER (Luxembourg Institute of Socio-Economic Research), APPLICA and the OSE (European Social Observatory). More information on the ESPN: http://ec.europa.eu/social/main.jsp?catId=1135&langId=en.