



# Romania's new law on pensions: addressing inequities or deepening gaps?

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*The new draft law on pensions aims to tackle the inequities between certain categories of pensioners in the main public scheme, by proposing a new formula that strengthens the link between contributions and benefits, and by linking the minimum pension benefit to the minimum wage. All pensions are expected to increase significantly. Yet in the absence of additional legal provisions and labour market incentives, measures to address inequities may increase the pension gap between some categories of pensioners, especially between men and women.*

## Description

In August 2018, the Romanian Government drafted a new law on pensions, aimed at tackling the inequities generated by the current system. This would be achieved by: a) tightening the link between paid contributions and benefits; b) consolidating the public pension system by defining more restrictive rules regarding the minimum contribution period; and c) linking the minimum pension benefit to the minimum gross wage, and establishing different levels, depending on the number of years in work.

The most important change introduced by the law is the proposed new pension formula. Under the current legislation, the pension benefit is based on a point system in which the accumulated pension rights are adjusted by the length of the standard full contributory period (SCP) and multiplied by the value of one pension point (PPV). Since 2001, when the pension point system was put in place, the SCP and the statutory pensionable age have been lower for women, and have been increased systematically over the years. Currently, the SCP is 35 years for men and 31 years for women, respectively 5 and 6 years more than in 2001, while the SCP for women is expected to be equal to that of men by 2030.

The new formula no longer uses the SCP as a factor in calculating the benefit, removing thus the different contribution conditions between men and women,

and between newer and older cohorts of pensioners, respectively. In addition, the new formula replaces the value of the pension point with the reference point (RPV) for converting pension rights into benefits. However, the law encompasses also a significant indexation of benefits. While under the current legislation the PPV is expected to increase according to inflation and growth in wages, the value of the reference point will be based on a pension point increased by 70% compared to its 2018 value (the pension point is expected to increase from 1100 RON (€231) in 2018 to 1875 RON (€394) in 2021).

The draft law also imposes a minimum contribution period of 15 years for all categories of beneficiaries, except for pensioners with severe disability and blindness, who become eligible for pension benefits after completing at least one third of the SCP. The minimum contribution period is already set at 15 years in the current legislation, but exceptions apply regarding invalidity benefits. Under the new provisions, all pensioners with lower contribution periods will be transferred to other forms of social assistance income support. Finally, the law links the minimum pension benefit (currently a fixed benefit of 640 RON, i.e. €135) to the minimum gross wage, and establishes its value at between a minimum of 45% and a maximum of 75% of the minimum gross wage, depending on the number of years worked over the minimum contribution period

Under the **current legislation**, the old age pension (OAP) is computed as:

$$OAP = PPV * \frac{\sum AS}{SCP}$$

where PPV is the value of one pension point;

the SCP is the length of the standard full contributory period;

the annual score (AS) is:

$$AS = \frac{\sum MS}{12}$$

where MS (monthly score) is calculated as a ratio between the actual income and the average national income.

Under the **new legislation**, foreseen to take effect in 2021, the new OAP will be computed as:

$$OAP = RPV * \sum AS$$

where the reference point value (RPV) is established at 75 RON (€15.7) and is calculated as the ratio between the value of PPV in 2021 and 25 (i.e. the average SCP over the last 4 reforms on pensions). RPV is indexed annually according to an inflation and wage growth-based formula.

## Outlook & commentary

The law has been proposed as a means to increase the adequacy of pension benefits and to address the inequities between men and women, cohorts of pensioners, and beneficiaries of the minimum benefit. The lower SCP for women and older cohorts of pensioners resulted in higher pension accruals for women than for men with similar careers, and for individuals who retired earlier rather than later. The law is removing the SCP from the pension formula, thus setting equivalent conditions regarding contributions across cohorts and genders, and linking all benefits to the actual contribution periods. All benefits are thus expected to increase

significantly, especially in the context of a substantial indexation of benefits by 2021. The increase, however, will vary depending on the length of the effective contribution period: longer careers will be rewarded to a greater extent, as a result of the new pension formula.

However, the more restrictive conditions regarding the minimum contribution period are likely to relieve the pension system of beneficiaries with short contribution periods (less than 15 years), and to help improve the sustainability of the system. Likewise, linking the minimum benefit to the value of the minimum wage is likely to better preserve its adequacy; also, staggering benefits according to the number of years worked will favour workers with longer careers on low incomes.

After being approved by the Parliament, the law should have been referred to the President for promulgation. However, the law is currently under constitutional scrutiny, as two opposition parties contested it at the Constitutional Court. A suspicion of unconstitutionality was raised with regard to the unequal contribution conditions required in case of invalidity pensions, as only blindness and contributions done under severe loss of work capacity are eligible for shorter minimum periods. The law has been also contested for discriminating the workers whose pension contributions have not been paid into the pension budget by their employers (given that only contributions effectively paid are recognised as eligible for a pension benefit). The sharpest criticism was levelled at the rocketing costs which could threaten the sustainability of the system: it is estimated that the pension budget will surge by 130% between 2018 and 2022, reaching 140 billion RON

(€29.5 billion), as compared to 60 billion RON (€12.6 billion) in 2018.

Overall, the law is an attempt to better align the main public “pay-as-you-go” scheme to a contributory principle and to create an even stronger link between contributions and benefits, while simultaneously increasing the adequacy of benefits. However, despite the positive changes, the new pension formula lays the foundations for a widening gap between individuals with longer and shorter times in work. For current pensioners, the new provisions tend to structurally disadvantage the older cohorts and women, for whom shorter careers tended to be the norm. Women, even with more advantageous retirement conditions, accumulate lower pension rights than men. The law ushers in equal treatment of men and women in terms of contributions, while leaving unfinished the gender agenda, maintaining lower pensionable ages for women. Thus, the gender gaps in pensions are likely to worsen, especially given the underdeveloped provision of social care and the rather weak policies aimed at improving the flexibility of the labour market. And, above all, even with a positive scenario of increasing numbers of employees and improved collection of contributions, the higher costs may prove unsustainable, as the social insurance budget has been under constant pressure during the last decade.

### Further reading

The Romanian Government (2018), Draft Law on the Public pension system, available at: <http://www.cdep.ro/proiecte/2018/700/20/5/se969.pdf>

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