

# Tax breaks for the construction sector in Romania: higher net wages, but lower pension rights

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*In Romania, the construction sector became in January 2019 the first economic sector with a minimum wage higher than the national minimum wage. The sector now also has the most generous fiscal facilities. On the one hand, people working in this sector are expected to enjoy significantly higher net wages. On the other, the social contribution for pensions has been reduced, which is likely to have a negative impact on workers' pension rights.*



## Description

The construction sector has been on a downward trend since 2008. Comprising approximately 500 thousand employees (or 8% of the total number of employees) and ranking the third among all economic sectors (after retail and manufacture), construction has lost a significant number of workers in recent years (in 2018 there were approx. 40 thousand workers less than in 2008), and has accumulated a high proportion of unqualified workers on the minimum wage (PIAROM, 2017). This is mostly because a large number of workers have migrated to third countries for better paid jobs. The deficit of workers is currently estimated at more than 70 thousand, and may increase in the near future.

In this context, since 1 January 2019, people working in the construction sector have been granted a minimum wage higher than the national minimum wage; this applies to the entire sector. Moreover, provided that the company turnover comes mainly from construction (i.e. at least 80% of it), monthly wages below 30,000 Lei (around €6,300) are subject to a series of tax exemptions, applicable between 2019 and 2028 to both employers and employees. These measures are contained in an agreement between the Romanian Government and the Federation of Owners of Building Companies (*Federatia Patronatelor Societatilor in Constructii*), establishing construction as a priority economic sector for the next 10 years and aiming at supporting its development with higher sectoral net wages.

The minimum wage is set at national level through statutory regulation; it is slightly higher for workers with tertiary education who have worked for at least 1 year in their area of specialisation. The construction sector is the first economic sector granted a differentiated minimum wage: its gross value is 44% higher than that of the national gross minimum wage (i.e. 3,000 Lei [around €630] compared to 2,080 Lei [€435]). In addition, in the construction sector, employees with wages above the minimum level (including from part-time work) and below 30,000 Lei (around €6,300) are now: i) exempted from income tax (flat rated at 10 %); ii) exempted from the 10% social healthcare insurance contribution; and iii) subject to a reduced contribution for pensions, resulting from a suspension of the transfer of contributions to the statutory funded scheme, for workers eligible for this component.

Payable by the employees, the social contribution for pensions is now set at 25% of gross wages under the general pension legislation, divided between the pay-as-you-go component (21.25% of the gross wage) and the statutory funded scheme (3.75% of the gross wage). The statutory funded component is mandatory for workers under 35 years old, and optional for those under 45 years old, while the withdrawal and, consequently, the transfer to the pay-as-you-go component are allowed after minimum five years of contribution. However, workers in the construction sector now pay a reduced pension

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contribution of 21.25 % of the gross wage (3.75 percentage points less than for all other employees). In compensation, the Government has suspended the transfer of the employees' contributions to the statutory funded scheme (3.75 % of gross wages) for the next 10 years.

For employers, the contribution for work insurance (work accidents, unemployment, sickness) has decreased from 2.25% to 0.33%. Moreover, the obligation to pay extra pension contributions for arduous and hazardous working conditions (4% and 8% of the gross wage, respectively) has been abolished.

## Outlook and commentary

The new law attempts to respond to employers' demands for fiscal facilities that could sustain higher net incomes in this sector and thereby make the sector more attractive and discourage outmigration. It is not uncommon for the Romanian legislation to envisage tax exemptions for occupational categories: workers in IT, in Research & Development, and in the restaurant industry are also exempted from the general income tax. However, the level of the minimum wage and the fiscal facilities granted to the construction sector are by far the most generous in this regard. Overall, the taxation rate for people employed in this sector has fallen from 41.5% to 21.25% of the gross salary, while the net minimum wage has increased by 87% compared to the net national minimum wage (for the increase in gross terms, see above). The impact of the new law on the situation of low-income workers is likely to be significant, given the high proportion of employees on the minimum wage working in this sector. Likewise, the tax benefits, addressing a wide range of incomes, are expected to attract a skilled

labour force, to counterbalance the high percentage of unqualified labour in this sector and, eventually, to discourage tax avoidance strategies for the payment of higher wages.

While the fiscal facilities were generally welcomed, the high level of the minimum wage, along with the restricted eligibility for tax exemptions, is triggering discontent among some employers. The high minimum wage raises problems in particular for small and medium-sized enterprises (SMEs), which rely mainly on minimum wage workers. Representatives of SMEs have complained that the higher minimum wage is weakening their capacity to pay wages and may have the opposite effect of encouraging informal employment or dismissals of employees. Likewise, the law has been criticised for disadvantaging companies that, due to lower revenues from construction relative to their total turnover, do not qualify for fiscal facilities, but have to comply with the regulations regarding the higher sectoral minimum wage.

Since its promulgation, the law has been widely discussed, especially in regard to its effect on employers and its benefits for employees' net incomes. However, little attention has been paid to the fact that the law entails a significant social cost for employees, as lower pension contributions prevent the accumulation of pension entitlements in the statutory funded component for the next 10 years. In all other sectors, the suspension of contributions to the funded scheme is optional. Moreover, while currently the statutory funded component covers a wide majority of the insured in the public system, very few workers have decided to withdraw from this scheme since January 2019, when the opting out

came into force. From this perspective, employees in construction are at a disadvantage, as the law imposes the temporary withdrawal from the statutory funded component, without foreseeing any measures to compensate for the non-accumulation in this scheme. Despite its positive impact on net wages, the law has mixed effects, in which current gains are partially obtained at the expense of curtailed pension rights, a future cost incurred by employees themselves.

### Further reading

Governmental Ordinance 114/2018 regarding some measures on public investments and other fiscal and budgetary measures:

[https://static.anaf.ro/static/10/Anaf/legislatie/OUG\\_114\\_2018.pdf](https://static.anaf.ro/static/10/Anaf/legislatie/OUG_114_2018.pdf)

Patronatul Investitorilor Autohtoni, Piarom, Studiu privind dinamica pietei muncii la nivelul principalelor industrii angajatoare din Romania [A study on the dynamics of the labour market at the level of the main employing industries in Romania]:

<https://www.piarom.ro/wp-content/uploads/2018/07/1.Studiu-privind-forta-de-munca-2017-principalele-industrii.pdf?x39362>

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