European Commission

# How the socio-economic responses to the COVID-19 outbreak are shaping the short-term policy on pensions in Romania

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Daniela Urse – European Social Policy Network July 2020

*Pensions have become a prominent issue during the COVID-19 outbreak, as the increasing public expenditure on measures aimed at cushioning its effect on the economy have overlapped with a significant increase in the pension point, expected in September 2020. In this context, the political parties have been mainly focused on attempts to reduce special pension benefits. Moreover, the government is considering proroguing the full indexation of benefits, while little attention has been paid to the minimum pension benefit.*



## Description

The COVID-19 outbreak, along with implementation of new legislation on pensions in 2019, has brought important challenges and competing priorities for the Romanian Government in the short and medium term. The Government introduced substantive measures aimed at protecting workers from income loss during the almost total economic lockdown put in place between 15 March and the end of May, and at sustaining employment and assisting companies during the post-lockdown recovery period. Meanwhile, the new legislation on pensions enacted in 2019 (Law 127/2019), and taking effect incrementally between 2019 and 2021, foresees a 40% increase in the pension point in September 2020 (from 1265 Lei [€261] in September 2019 to 1,775 Lei [€366] in September 2020). While this will be the highest increase in pension benefits over the last 30 years (Romanian Fiscal Council, 2020a), the law also introduces a change in the pension formula and in the calculation of the minimum benefit, which will result in a further increase in the level of benefits in 2021.

In this context, in which policies aimed at cushioning the effects of COVID-19 on the economy are competing with the need to comply with the new legislation on pensions, the high level of special pension benefits has become the subject of public scrutiny. The special pension schemes apply to several occupational categories in the public sector, covering approx. 3% of the total number of pensioners (i.e. approx. 180,000 beneficiaries). The benefits are calculated as a percentage (i.e. between 65% and 85%) of the average income earned in the last month or in the last 6 or 12 months before retirement (depending on the occupational category). The average benefit varies between 3915 Lei (€808) for military employees in December 2019 and 19221 Lei (€3970) for magistrates in June 2020; these amounts are several times higher than those paid by the main pay-as-you-go (PAYG) scheme - 1383 Lei (€285) on average in June 2020.

A law aimed at scrapping part of these schemes was rejected by the Constitutional Court in May this year. This has encouraged the political parties to resume measures aimed at diminishing the special pension benefits, in order to address the inequities between benefits. A new draft law proposing progressive taxation of special pension benefits was voted through by the Chamber of Deputies in June this year. The draft law modifies the fiscal code and introduces a progressive tax, varying from 10% for benefits higher than 2000 Lei (€413) to 85% for benefits higher than 7000 Lei (€1446). The Romanian fiscal legislation imposes a flat tax of 10% on all incomes, and consequently all pension benefits beyond 2000 Lei are taxable under this rule; the draft law introduces a special tax, additional to the general income tax, on the part of the benefit which exceeds the amount calculated according to the contributory formula used in the main PAYG scheme.

Representatives of magistrates and the Ombudsman challenged the tax at the Constitutional court, considering it an attempt to impose a double fiscal burden on certain pensioners and to introduce discriminatory fiscal treatment for these categories.

## Outlook and commentary

While several other similar drafts have been submitted to Parliament for debate (the oldest one stemming from 2016), the draft law on the taxation of special pensions was approved by the majority of Parliamentarians in the Chamber of deputies, with the argument that resources were clearly needed for implementation of the new legislation on pensions in September 2020 or to deal with the effects of the COVID-19 pandemic. The measure particularly affects those schemes providing higher benefits, especially those for magistrates, workers in civil aeronautics and former workers of the Court of Accounts, whose average benefits significantly exceed the proposed threshold. However, in total, fewer than 20% of special pension beneficiaries (i.e. approx. 35,000 beneficiaries) would be subject to the higher level of taxation (85%), according to the explanatory memorandum to the draft law. Thus, the impact on the pension budget would be relatively marginal, estimated between 0.5 billion and 1 billion Lei (€0.1-0.2 billion) - i.e. between 0.65% and 1.2% of the pension budget.

In contrast, the indexation of the pension point in September 2020 will generate a cost of 10 billion Lei (€2.07 billion) for 2020, and 22 billion Lei (€4.55 billion) for 2021. This is expected to trigger an increase in social expenditure amounting to 0.6% of GDP in 2020, and 1.85% of GDP in 2021, also taking into account the additional increase in benefits foreseen for that year (Romanian Fiscal Council, 2020a). The fiscal deficit has already skyrocketed in the first months of 2020 and has reached 38.8 billion Lei (€8.02 billion) (3.59% of GDP); half of this has been generated by fiscal facilities and exceptional measures undertaken in the context of the COVID-19 pandemic (Ministry of Finance, 2020). For the whole year, the deficit is expected to increase to a value between 8.1% and 10.3% of GDP, depending on the level of economic compression (Romanian Fiscal Council, 2020b). With approx. 600,000 workers (i.e. 7% of the total number employed) receiving the allowance for technical unemployment caused by COVID-19, and an estimated 700,000 workers (i.e. 8% of the total number employed) losing their jobs or returning from abroad during the pandemic, the government has made it a priority in the short and medium term to revitalise the economy and sustain jobs through active labour market measures. With regard to pensions, the most positive scenario put forward by the government is an indexation of the pension point in line with the level of indexation applied in previous years (i.e. between 10% and 15%). No information has yet been provided regarding the minimum pensions, which are currently subject to ad-hoc indexation rules and are expected to be recalculated only at the beginning of September 2021, according to the new law. While the proposed taxation of special pension benefits has a low impact on the pension budget and is unlikely to be accepted by the Constitutional Court, the initiative points to a political strategy aimed mainly at responding to public expectations and at gaining electoral capital in view of the upcoming general and local elections (foreseen at the end of the year). Yet, neglecting the indexation of the minimum pension benefit could exacerbate the inequity between benefits, and places the minimum pension beneficiaries among the main losers of the economic crisis caused by the COVID-19 outbreak.

## Further reading


Romanian Fiscal Council (2020a), "Opinia Consiliului Fiscal privind Legea bugetului de stat si Legea bugetului de asigurari sociale pentru anul 2020" [Opinion on the Law regarding the state budget and on the Law regarding the social insurance budget for 2020]: http://www.consiliulfiscal.ro/Opinie%20CF%20buget%202019.pdf

Romanian Fiscal Council (2020b), "Raport annual 2019" [The annual report, 2019]: http://www.consiliulfiscal.ro/RA%20CF%202019.pdf

Draft law on the amendment of Law 227/2015 regarding the Fiscal Code: http://www.cdep.ro/pls/proiecte/docs/2019/pr396_19.pdf

Ministry of Finance, "Executia bugetului general consolidat" [Monthly report on the general Government consolidated budget], May, 2020, https://www.mfinante.gov.ro/static/10/Mfp/buget/executii/nota_bgcmai2020.pdf


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