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Weekly Briefing

Romania Economy briefing:

2017 summary of main economic developments in Romania

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Fiscal changes with an important pressure for the actual and future economic development of Romania were the most important features that shaped the 2017 economic year. The first part of this briefing presents the main economic events, while the second part analyses their impact and provides insights related to Romania’s macroeconomic environment.

1. **Two major events shaped the economic reality of 2017**:

- the unitary wage Law;
- the changes of taxes and other fiscal measures.

a) **The unitary wage Law** was adopted by the Romanian Parliament on June, 7, 2017, establishing a unitary payment for the employees in the public sector. Romania long needed such a law, given the wage inequalities and dysfunctions in this sector.

While initially the main salary increases were announced for July this year, the Government decided to postpone them for the beginning of 2018. In essence, the main changes point to a 25% increase for all the wages in the public sector since January 1, 2018. A particular attention is directed towards the personnel in the healthcare and education domains, for improving their salary level. Therefore, the basic salaries of doctors and nurses in the public health establishments will increase to the base salary level set for 2022 since March, 2018, while the staff in education will see an increase by 20% compared to February 2018 from the same date. Other changes are related to holiday and food allowances, the payment of staff working on European non-reimbursable funds projects and in local public administration etc. The law is also meant to reduce the difference between the lowest and the highest salaries in the public sector, increasing with a higher percentage the lowest basic wages. The Labour minister stated that 60% of the wages will therefore be doubled, while 3% of them – the largest ones – will decrease. It is expected that the ratio between the minimum and the maximum basic salary in the budgetary sector to be reduce from 1 to 15 at present to 1 to 12, due to these measures.

The unitary wage law will enhance a growth by 56% of the salaries in the public sector by 2022, entailing a total budget of 32 million lei by 2020 and 43 billion by 2022, according to the Labour Minister. The IMF estimated in May, prior to the adoption of the law, that such measures will generate a total cost of 61.2 billion lei, or 6.6% of GDP. The international institution expressed its concern related to the significant fiscal risks that are enhanced by the magnitude of these measures, while recommending clear principles of sustainability, fairness, transparency and relative simplification for the future increases. Subsequently, the Finance Minister announced a budgetary impact of 75 billion lei, namely 8.6% of GDP, significantly above the IMF estimates, but considering it as sustainable by the Romanian budget, despite the analysts' gloomy forecasts.

Half a year after the adoption of this law, through the changes to the Fiscal Code, the Government took the decision of transferring the social security contribution (SSC) from the employer to the employee. Under this new approach, the net increases expected to be generated by unitary wage Law will be affected, at least in the first year, due to the fact that much of the wage increases will return to the state budget as fees paid by the employee. In this way, a problem that would otherwise have been exacerbated for the state budget is partially solved. Therefore, while the budgetary deficit problem is temporarily solved, this measure has two major effects on the long term:

- For the public sectors employees, there will be no major increase of wages, like the ones announced at the beginning of the year, by 50% or even 100%. The amounts of money required by the fiscal change will be covered exactly from the salary increases mentioned in the unitary wage Law.
- While the unitary wage Law was only for the employees in the public sector, the SSC measure is affecting all the Romanian employees. In this way,

private companies are somehow forced to increase the gross wages for their staff, in order to preserve their net salaries after the transfer of contributions.

The problem with the salaries in the public sector is not completely solved, and there continues to be critical domains that require a solution, such as healthcare and education. For example, one of the major causes of Romanians' doctors and nurses' migration in other EU countries is the low remuneration. The Government measures from this year are not enough for covering the wage needs in these areas.

b) Romania witnessed this year important **changes of taxes – in both directions: increases and decreases – and new fiscal measures**. Still, the tax decreases, like the reduction of the income tax from 16% to 10%, are counterbalanced by new taxes or price increases.

The excise duty on fuel increased in two stages, on September 15 and on October, 1 this year, in an attempt of aligning the current levels of excise duties in Romania to the EU requirements, as motivated by the Government. These led to an important decrease of fuel sales, due to the fact that carriers started to buy fuel from neighbouring countries, as they have already threatened the Government. This measure means lower amounts of money for the state budget. In addition, it generated price increases in the whole economy.

A new car tax, calculated based on the degree of pollution of the vehicle, is announced to be prepared for the next year. The measure comes after a decision of the European Justice Court for eliminating a similar tax, considered illegal. As a consequence, this year the number of second-hand, used cars, registered in Romania, grew by 50% as compared to the last year. While Romania follows indeed a European recommendation for reducing pollution, the Government found a solution allowing it to counteract the elimination of the previous tax and to increase the budgetary revenues.

The "solidarity tax" for the employers in case that their company would go into insolvency, also known as the insurance contribution for work, jumped by

2% and is meant to feed the Guarantee Fund for the payment of wages and benefits.

The other measures changing the Fiscal Code were presented in a previous briefing related to Romania. The main problem is that such measures fuel the unpredictability of the business environment; the date of entry into force is only 2 months after their adoption. In addition, while the average number of amendments to the Fiscal Code at European level is 60 a year, Romania made over 260 changes in the first 11 months of 2017, according to the president of the National Council of Private Small and Medium Enterprises in Romania (CNIPMMR).

2. The impact of such decisions on the Romanian economy

While these events have occurred predominantly in the second part of the year, some of them have already altered the macroeconomic indicators. Hereinafter, we will provide an analysis of the main economic evolutions in Romania, emphasizing the impact of the measures presented above.

a) Important growths

Romania's GDP had a strong growth since the beginning of this year, as a result of previous measures that enhanced the private consumption, such as the reduction of the VAT in June 2015 and January 2016 and the raise of the minimum wage. The economic growth of 8.6% in the third quarter of 2017 as compared with the same quarter of the previous year is the largest in EU, while the EU28 average in the same period is 2.6%. Romania accumulated an economic growth of almost 7% in the first nine months of 2017, and the most recent estimates indicate an increase in GDP between 5.7%-6.5% for the whole year.

The growth of exports in the first ten months of 2017 reached 9.6% on a year-on-year basis, for values calculated in lei. The main exported products (46.5% of total volume) were machinery and transport equipment.

The net average wage increased by 13.5% in the last year, if we compare the last available data for October. This means an increase with 52 euro, from 469 euro in October 2016 to 521 euro in October 2017. Still, there are major gaps between sectors of activity; the highest net average wage is in the IT sector, 4.3 times higher than the wage for the personnel working in the hotel and restaurant area.

b) Main weaknesses

The main weaknesses point to a pro-cyclical mix of economic policies, contraindicated in periods of economic growth.

The economic growth is 90% based on the households' consumption, while the investments are at minimum levels. The volume of imports grew with 12.4% in the first ten months of this year as compared to the same period of 2016 for values expressed in lei, while the trade deficit has deepened with 29%. The European Commission notices a clear increase in the Romania's Actual Individual Consumption (AIC)[1] per capita, from 56% of the EU average in 2014 to 58% in 2015 and to 61% in 2016, the largest increases in both 2016 and 2015. While an increased consumption is not bad in itself, in Romania's case in not supported by a similar increase of the economic activity. GDP per capita in Romania increased by only 3 percentage points in 2016 as compared to 2014 and by one percentage point in 2015 as compared to 2014. This pattern of the Romanian economy is not healthy for a long term economic growth.

The budgetary deficit has managed to be kept under control without exceeding the limit of 3% of GDP with great efforts for this year, again given that there are no major investments.

Both wage increases and the new excise duty on fuel led to an increase in the inflation rate, which became positive after two years. The prices increased

[1] Actual Individual Consumption is defined as „the goods and services actually consumed by individuals, irrespective of whether these goods and services are purchased and paid for by households, by government, or by non-profit organisations", http://ec.europa.eu/eurostat/documents/2995521/8536114/2-14122017-BP-EN.pdf/0c8f87ee-42e8-4474-b7c6-724515917ea5.

with 3.2% in November 2017 as compared to November 2016. The inflation forecast for the end of this year was revised to 2.7% by the National Bank of Romania, compared to the previous forecast of 1.9%, following the increases in taxes. Also, Romania saw in November this year a sharp currency depreciation, with risks of following such trend for a longer period.