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Romania Economy briefing:

Intentions of raising the minimum income

Oana Cristina Popovici

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.
Szerkesztésért felelős személy: Chen Xin
Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.
+36 1 5858 690
office@china-cee.eu
china-cee.eu

Intentions of raising the minimum income

The Government announcement regarding the intention of a new increase in the minimum income raised strong opposition from the part of the economists, the companies in the private area and the institutions representing the foreign enterprises in Romania. While the Minister of Labour advocates for a positive impact on GDP, on attracting new labour force and on reducing unemployment among young people, the main concerns of the private environment emerge from the fear of inducing unfair competition, negative consequences for the performance of the private sector and lack of correlation with the evolution of employers' productivity. The tendency to further stimulate consumption, through this measure, is compensated by another one recently taken by the National Bank of Romania, who decided to limit the indebtedness level for population starting from the 1st of January 2019.

The Government intention related to a new raise in the minimum income was mentioned in October, when the draft of the Government Decision on this topic was presented to the representatives of trade unions and employers' organizations. The last raise was in January 2017. While the trade unions demanded a minimum wage increase from November 1st, employers have requested a postponement by the 1st of January 2019. The minimum wage will be increased to 2080 lei/month (452.2 euro[1]), a net increase of 100 lei (21.7 euro[2]) as compared to the present value. The Government also decided to re-establish the minimum guaranteed gross salary in payment, differentiated according to the level of education or the work experience, which was applied in Romania before 2011. In this case, the salary would be 13% higher than that earned by people without higher education or with less than 15 years of experience on the labour market. Recently, the Minister of Labour announced

[1,2] At an exchange rate of 1 euro = 4.6 lei.

that the minimum wage will increase starting with the 1st of December, while the differentiation based on studies and work experience will come into force from the beginning of the next year.

While there is no budgetary impact and the supplementary spending are considering to remain within the limits of the allocated state budget, according to the document of the Labour Ministry, the National Commission for Strategy and Prognosis (NCSP) within the General Secretariat of the Government states that the raise of the minimum wage taking into account the mentioned differences has a positive impact on GDP of about 0.15 percentage points in 2018 and of 0.8 percentage points in 2019. The NCSP's arguments indicate that this increase has a positive outcome on the long-term growth potential of the economy, as increasing the minimum wage stimulates consumption and aggregate demand and, implicitly, economic growth, while the consequences for the inflation are negligible. Such a measure is necessary as there is an acute shortage of the labour force and it could encourage the growth of jobs in the formal sector of the economy, by reducing the inclination of certain categories of employees to leave this sector, and increase participation in training programs. In fact, the number of employees increased by more than 550,000 as compared to 2013, despite the duplication of the gross minimum wage in nominal value in the same period. Another positive result would be the reduction of the income inequality, as Romania ranks the 7th in the EU in terms of high income inequality, over the EU average.

Moreover, the empirical analysis of the NCSP evidenced that the increase of the minimum wage by 1% led to an increase of the employment rate of young people by about 2%, as a result of the increase of the labour market integration incentives in the period from 2000 to 2017. The young people unemployment rate reached the lowest minimum in the last 20 years in the second quarter of 2018, of 15.5%. A comparison of the minimum wage level expressed in euro evidences the third lowest level for Romania among the countries in the EU.

Several representatives of the private environment manifested their discontent related to this measure. The Romanian Businessmen Association states that such a measure is affecting the performance of the socio-economic environment and the private sector, especially for the manufacturing sector, inducing an unfair competition. Moreover, the Association accuses that the increase of wages in public administration, health and education, without the application of performance criteria, has not led to an improvement of these services for businesses and citizens. Moreover, the postponement of digitization of public services puts pressure on new employments, as 15.000 new persons were employed in 2017 in central and local public administration.

The Romanian-German Chamber of Commerce (AHK) considers that the intention to raise the minimum wage is taken randomly and without a prior impact study, which could cause the reduction or even interruption of certain activities in the future for several German companies in Romania, especially those in the manufacturing industry. The main concern is that the increase of the salary did not follow a similar raise in productivity. That could be compensated only through massive investments in vocational and university education, in infrastructure projects and by ensuring the stability of the economic environment. The connection with the experience on the labour market tends to discourage the productive workers newly employed.

The increase is also contested due to the fact that the wages in the public area are, on average, 30% higher than those in the private environment. Moreover, the differentiated salary based on the education level risks to lead to an explosion of diplomas and is not relevant, as the salary should be connected to productivity. The president of AHK suggests that the minimum wage should be differentiated based on the type of the economic sector and the area, and considers that a better measure would be the adoption of a minimum wage per hour, especially that it would be more helpful for part-time contracts, as the business environment has to pay part-time social contributions at the level of the entire minimum wage even if someone is hired for 2 or 4 hours a day. The differentiation based on the sector of activity is also supported by the president of the Fiscal Council.

Instead, he recommends a better supervision of the whole economic situation, especially as regards the increase in consumption, which should be gradual. This would allow to avoid an immediate increase of inflation and of the ROBOR index, based on which the loans in domestic currency with variable interest are calculated, which otherwise would annihilate the wage growth and therefore would have no impact on raising the living standards.

This week, an IMF delegation is present in Romania for seven days with the aim of analysing the latest economic and financial developments, updating the forecast of macroeconomic developments and discussing the 2019 budgetary plans. Although Romania does not have a financing agreement with IMF, the financial institution is annually assessing the financial and economic situation at national level in a surveillance exercise which is mandatory for all Member States and provides general recommendations on monetary, financial and economic policies for ensuring stability and a positive evolution in the economy.

In a similar vein, the chief economist of the World Bank for Europe and Central Asia, Hans Timmer, warned that there are unexpected dangers that could hit the economy; in this case, he recommended, for Romania, a lower level of the current account deficit, less pressure on inflation and more focus on the long-term problems than the ones in the short run.

Concerns related to high consumption of population are present in the market. The National Bank of Romania (NBR) took the decision to limit the indebtedness level for population, establishing a clear benchmark for each type of loans starting with the 1st of January 2019. Therefore, the rate for the loans in domestic currency could not surpass 40% of the net income, should be maximum 20% for loans in foreign currencies, while the maximum level of indebtedness for the loans targeted to purchasing the first dwelling is increased by 5 percentage points. The central bank highlights, thus, that the population's indebtedness exceeded the signal threshold, according to European norms, especially on the segment of low-income population categories. The representatives of the NBR state that this regulation is targeting especially small loans, which are also the most dangerous, but will not affect real estate lending; moreover, the calculation method is simpler and less bureaucratic. At the moment, according to the current system, the market's average debt ratio was 47% for mortgage credit and will drop to 45% for the first dwelling, while the market average for consumption was up to 45% and will drop to 40%. Still, some banks provided loans accepting a level of indebtedness of 70%. The measure is taken in circumstances where NBR has repeatedly expressed its concern about the indebtedness of the population, especially related to those with the lowest incomes, which had an average indebtedness of 53%, compared to 20% for the debtors who earn more than twice the average wage. In all, it is expected that the sector of real estate loans, which is the engine of lending, would not be discouraged, as usually people with incomes above average are contracting such types of loans.