Minimum wage – labour market rigidity factor

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Abstract. Currently setting minimum wages is a common practice that targets economic and social aspects. This paper aims to analyse the evolution of the minimum wage in Romania compared to EU Member States and the effects that it generates on employment, labour productivity, reducing social and wage inequalities etc. Given the current concerns about the importance of labour market flexibility to be able to respond to different shocks, as the economic crisis, we evaluate the minimum wage burden as a factor of rigidity in the labour market in terms of its rise and the ratio between the minimum wage and the average wage and the perverse effects on employment.

Keywords: minimum wage, labour market rigidity, employment, labour productivity, social inequalities.

JEL Classification: J31, E24.
1. Why the minimum wage? Defining the context: globalization and the European social model

In today's society, factors such as technological progress, low transport costs and liberalization within and outside the European Union have led to increased foreign trade and investment flows across countries. Globalization implies increased competition, considering both low-cost economies such as China and India, and innovative economies like the United States, both developed countries like England or Germany and developing economies.

The liberalization of trade flows and relocation of industry have determined on the one hand pollution effects and social crises, as well as the promotion of some technologies and higher yields, the creation of jobs in disadvantaged areas, improvement of the living conditions for the population, low literacy, better life chances by eradicating diseases etc. This is because under the pressure of the civil society, investors have got involved in various social projects, corporations have promoted better working conditions and social protection measures, environmental issues have become the subject of international law regulations, income and benefits generated at national level allowing a growing trend in rising living standards and life aspirations in the countries concerned. All this confirms the need to continue the process of globalization and strengthens the belief that not the purpose, but the methods and tools are inappropriate to the new realities (Stiglitz, 2002).

The rapid liberalization of trade and increased imports/exports can cause dislocations (disturbance) on the labour market. Also, the technological changes - an important part of the globalization process - are often suggested as an alternative explanation of the problems on the labour market.

Given the rapid accumulation of capital - both trade and technology can amplify the vicious circle of the economic growth, of jobs and of increasing productivity. If capital accumulation is slow, the economic growth is also low, trade development and technological progress may lead to unemployment and worsen income inequality.

Globalization compels the EU to adapt its pace in all sectors where competition intensifies, the labour market cannot remain outside the growth areas of the competition even if it is considered among the least globalized of the international markets.

The need for the social aspect given the intensification of globalization has become increasingly intense in the European Union. Although the focus on the social side of the European model appeared along with the European Economic Community in the Treaty of Rome, the concept of the European social model appeared later used by the European Commission President Jacques Delors in the 90s and refers to the harmonization of the economic growth and social cohesion. Although there is a wide variety of such model the EU strategy is common and it pays great attention to environmental and social issues in modernization efforts (Werner, 2006).

Intensifying competition associated with globalization, the development of new technologies and the effects they produce on jobs, aging population and slowing economic growth have made it necessary to change the orientation of the European social model from welfare state, which involves providing resources to guarantee the security of individuals in transitional periods, to workfare state, aimed at providing them with tools that enable them to deal with risks posed by the current changes. It is supported a
reduction in the passive intervention in the favour of active involvement by creating jobs, qualification, requalification activating labour market policies. However, it is kept the particular importance of certain issues concerning wage policy which should be carefully considered due to their correlation with inflation, labour productivity, and migration. The minimum wage remains in the attention of policy makers at national and EU level, bringing into question in the current period the importance of setting minimum wages in all EU countries and, in perspective, setting a minimum wage in Europe.

2. Approaches on minimum wage

Approaches on the minimum wage are contradictory. Supporters believe that it is a way to improve the wellbeing of individuals, especially of those with low incomes. Opponents consider it is a way that turns against workers excluding them from employment, reducing rather than increasing their welfare. Establishing minimum wage must reconcile social considerations with economic ones. The social considerations refer to the standard of living and income inequality that lead to pressure for increased minimum wages (pressure coming particularly from trade unions). The economic considerations related to productivity, competitiveness, job creation lead to pressures (often from employers) to maintain a low minimum wage (Rutkowski, 2003). The minimum wage set at a moderate level usually does not have the effect of lowering employment, but it has limited and transient effects on the low-income population. It tends to reduce income inequality, but the effects on poverty are lower.

The minimum wage can act as rigidity on the labour market because employers cannot lower the minimum wage to equalize the labour productivity level. Since the productivity of workers is below the minimum wage, it turns into a burden for employers reducing their competitiveness and ability to adapt to the changing economic conditions (Neumark and Wascher, 2003). In addition, a high minimum wage has negative effects on the level of employment. (Herr et al., 2009)

Beyond the direct influence on the labour market, the minimum wage may result in tax evasion by making employers declare lower wages, often at the level of minimum wage, in order to reduce non-wage labour costs.

Thus more productive workers receive salaries at the level of the minimum wage, while workers with low education level are the ones who really get these salaries (Tonin, 2007). Another important issue related to the minimum wage is the existence of the informal economy and the fact that the minimum wage is losing importance in these conditions, an extensive informal sector and a large number of workers limit the importance of the minimum wage in the economy, yet retaining the guiding role even in these conditions to set the salary levels.

It is estimated that the minimum wage in Central and Eastern Europe was maintained at a level too high (Lehmann and Muravyev, 2011). This differs considerably from country to country, compared to the purchasing power or average wage. The minimum wage burden is expressed most frequently by the ratio between the minimum wage and the average wage in the economy. The higher this ratio is the better the position of workers placed at the level of the minimum wage is, but the effects on employment are more perverse.
Taking as reference of the average wage, it is not the most conclusive basis due to the changes at the upper level of the hierarchy of income where we find the workers with the highest level of training. Such a comparison does not reflect labour market conditions facing the low-productivity workers. It is considered that the median value of the salary (half of the workers earn more than this value, half of them less) is a more relevant benchmark to analyse the impact of the minimum wage (Rutkowski, 2003).

3. Minimum wage in the European Union

Establishing a minimum wage has become a common practice in most EU countries. It is set in two ways: either it is set by the government, possibly on the basis of consultations with trade unions and employers, or established through collective bargaining (bi or tripartite) at national or sectoral level. The purpose of introducing such income is to prevent exploitation of employees by employers, to promote a correct structure of wages, to lower and protect against poverty, to reduce wage gap, and last but not least to protect and motivate employees with low incomes.

EU countries except Cyprus, have introduced mandatory minimum wage levels or levels of minimum wages set by collective bargaining (Austria, Denmark, Italy, Finland, Sweden). In July this year Germany has also decided to introduce the minimum wage starting with 2015.

The UK introduced the minimum wage in 1999, a much discussed measure in terms of the impact on employment, of its reduction. The studies undertaken at national level in the UK showed that, overall, the impact on employment has not been strong, employment was affected only in certain fields and for certain periods of time. (ONS UK, 2012)

Beyond existing or not, the most important element regarding the minimum wage is the way of setting it so as to be effective. On one hand one must ensure a minimum standard of living for workers, and on the other hand, it must be correlated with the level of labour productivity so as to not cause unemployment for workers with low productivity. The burden of the minimum wage as labour market rigidity factor is expressed most frequently by the ratio between the minimum wage and the average wage in the economy. The higher this ratio is the better the position of workers placed at the level of the minimum wage is, but the effects on employment are more perverse. Taking as reference the average salary is not the most conclusive basis due to the changes at the upper level of the hierarchy of income, where we find the workers with the highest level of training. Such a comparison does not reflect the labour market conditions facing the low-productivity workers.

Therefore, it is considered that the median value of the salary (half of the workers earn more than this amount, half of them less) is a more relevant benchmark to analyse the impact of the minimum salary (Rutkowski, 2003).

There is a variety of levels of minimum wages both as absolute value and as relation to the average wage. In the European Union, the minimum wage as a percentage of the average wage in industry, construction and services are between 56.4% in Greece and 31.7% in the Czech Republic. Romania records a level of 34.1% in 2013, slightly up compared to the previous years (Figure 1).
Figure 1. Minimum wage as% of the average wage, EU, 2013

Note: Data from Belgium, Estonia, France, the Netherlands and Romania refers to 2012, Greece to 2013.
Source: Eurostat Statistics, earn_mw_avgr2

It is important the relationship between the minimum wage and average income, but it must be also analysed the distribution of wages by income levels. The higher the share of people receiving a salary at the level of the minimum wage is, the greater the effect on reducing income inequality is. The low level of the minimum wage as a percentage of the average wage must be analysed in relation to the structure of employees by wage groups. In Romania, over 70% of employees have a wage level below the average wage. This aspect asks questions related to the efficiency of its social function.

4. The role of the minimum wage in reducing inequality and social exclusion

Minimum wages aim to reduce social and wage inequalities, for employees a guarantee against the risk of poverty and social exclusion.

Antony Atkinson (1998) refers to three essential aspects that are found in many definitions regarding social exclusion: 1) characteristics of time, place and specific social groups; 2) the person's inability to overcome the situation by themselves, making the difference between not wanting to work in the labour market and the impossibility of finding a job; 3) the future prospects of persons and not only the situation at the moment. The same issues are found in other definitions of this phenomenon (Castells, 2000).

Social exclusion is analysed in conjunction with redundancies as a result of stringent measures to protect employment, with temporary employment and minimum wages affecting employment for the low-skilled (Cahuc and Malherbet, 2002).

It confirms the current concerns about employment security and Rodriguez and Russo (2006) who show based on a vector autoregressive model that employment volatility increases due to increasing mobility between jobs and not the mobility between employment and unemployment.
In this regard, active employment policies are effective in reducing the volatility of unemployment in countries with rigid labour markets (Gnocchi and Pappa 2009).

Reform programs must ensure investment in successful transitions on the labour market, developing appropriate skills through education and training system so as to achieve effective fight against poverty and social exclusion, reducing structural unemployment, youth unemployment and inactivity, productivity growth so that it not to transform the minimum wage into a labour market rigidity factor (European Commission, 2010).

A minimum wage set at too high a level stimulates the expansion of the informal sector, discouraging the respect for this level imposed by law or under collective bargaining, while a minimum wage set at a moderate level can be more effective in protecting the workers' incomes with little education and low income.

Figure 2 shows the relationship between the risk of poverty and social exclusion in the European Union for the entire population, compared to employees. It is noted that, of all the member states, the risk of poverty and social exclusion for employees is the highest in Romania (32.5%, while the EU average was about 13.3% in 2013). Nevertheless, the risk of poverty and social exclusion for the entire population, although high, does not place us on the same position, Bulgaria recording a higher level. In Romania the status of employee is not a powerful weapon against the risk of poverty or social exclusion. This discrepancy is correlated with the distribution of wages by income group, respectively with the high number of people who have income below the average wage.

Figure 2. Population at risk of poverty and social exclusion (% of total) EU, 2013

Note: The data for Ireland refers to the year 2012.
Source: ilc_peps02
It is estimated that the minimum wage has an active role in reducing social and wage inequalities, it effectively represents a guarantee against poverty for those employed. In Romania the risk of poverty for those who have job (in-work at risk of poverty rate) was of 21.5% in 2012, well above the EU average which was of 11.7%.

Eurostat statistics show that countries that have the highest risk of poverty also recorded the highest income inequality. Greece, Bulgaria, Latvia, Romania recorded in 2013 the highest level of inequality of income distribution in the European Union for the population under 65. Income inequality may, however, have adverse effects on the labour productivity through the lack of motivation and the disincentive to improving skills.

5. The minimum wage in Romania

In Romania the minimum wage was introduced in 1991 by wage law and is established by Government decision, after consultation with trade unions and employers (Wage Law no. 14 of February 8, 1991).

The statistical data published by the Ministry of Labour in Romania allows us to analyse the evolution of the minimum wage compared to the average wage in the national economy (including in agriculture). Figure 3 shows that in 1990-1995 the minimum wage decreased rapidly compared to the average salary amid economic reforms and low productivity of state enterprises. During the crisis, as in many other European Union member states, the minimum wage increased compared to the average wage, a trend that is maintained in 2014.

Figure 3. The evolution of the minimum wage in Romania, 1990-2014

Note: minimum wage is the one recorded at the end of the year, for 2014 were taken into account minimum and average wages in September.

Source: www.mnnunci.ro, statistics section

In Romania 5.05% of all employees in the month of October 2012 received a salary less than or equal to the minimum wage, with a higher share for men -5.39%, compared to women - 4.67%. Regarding the distribution of employees by activities of the national economy (Figure 4), it is noticed a much higher level than the national average of employees that are at the level of the minimum wage in the service sector. The most significant differences are in administrative services and support services (11.34%) and in
Another sector of services: hotels and restaurants (10.67%). The situation can be explained in these sectors through the higher share of the informal economy and the low level of foreign direct investment (which is not generally associated with the informal economy). This refers to the situation where employers declare income at the level of the minimum wage to reduce non-wage labour costs, the wages actually received by employees exceeding this level. The size of the informal sector is the one that really determines the impact of the minimum wage in Romania and in other countries in Central and Eastern Europe.

At the opposite pole are financial intermediation, a sector where only 0.4% of the employed population is at the level of the minimum wage. This sector held on 31 December 2013, over 14% of the stock of foreign direct investment in Romania.

The existence in agriculture of a low share of employees who have earned income below and at the level of the gross minimum wage per economy is explained by the fact that in this sector the share of employees in total employment is very low, the majority of the population employed in agriculture is self-employed or unpaid agricultural workers.

**Figure 4. The percentage of employees below and at the level of the minimum wage in Romania per activities of the national economy, in October 2012**

![Figure 4](image)

*Source*: calculations based on INSSE study. Distribution of employees by groups of wages earned in October 2012.

The analysis by type of ownership (Figure 5A) shows that the high incidence of minimum wage is recorded by firms in *fully private ownership* (7.93% of all employees), given that these companies hold approximately 50% of all employees in the economy. Under this form of ownership, the wages are concentrated about 89% by groups of salaries under 3000 lei. In the *state sector* is employed 6.9% of all employees in the economy, and of these only 0.2% is at the level of the minimum wage and receive gross wages under 3000 lei approx. 68%.
Figure 5. Employees below and at the level of the minimum wage per economy, by property type (A) and enterprise size class (B)

Source: calculations based on INSSE study. Distribution of employees by groups of wages earned in October 2012.

Considering the enterprise size classes shows that in companies fewer than 50 employees, 11.95% of employees is below or at the level of the minimum wage. In these companies is employed 22% of all employees in the economy.

Although these micro-size companies have a small force in the market in terms of bargaining power, investment in development, they are an important source of jobs. (Trașcă, 2014)

In large companies with over 250 employees is employed 53% of all employees in the economy and only 1.47% of them received a salary less than or equal to the minimum gross salary per economy in October 2012 (Figure 5B).

Thus, an increase in the minimum wage in Romania will particularly affect the private sector and small businesses as well as companies operating in the service sector.

5. Minimum wage and labour market rigidities. Correlations with the level of productivity

The rigidity of the labour market is a very important issue for the economies of the world, especially in times of crisis when need to face the competition requires employees and employers to increase their capacity to adapt to market needs. The rigidity of the labour market is a complex issue and requires interrelated approaches involving multiple conditionings.

With regard to labour market rigidities, it can be emphasized the fact that there is no precise definition, the concept is defined by the speed of adjustment to shocks (Pissarides) and by listing or evaluating its effects (Solow, 1998). The labour market rigidities issue has gained importance in recent years because it causes slow adjustment to changes in the global economy and investment opportunities. For Romania, which is preparing for the entry into the Monetary Union, the problem becomes more acute given that by giving the monetary policy to the European Central Bank and setting the exchange rate of the euro, increases the need to know to what extent the current labour market rigidities may be obstacles to future shock absorption and the necessary measures to mitigate them, by increasing the degree of labour market flexibility.
The minimum wage is a factor of rigidity in the labour market because it prevents the rapid adjustment to changing conditions. For employers the burden of the minimum wage imposes the analysis of the efficiency of new employment through comparisons with the level of productivity: if the productivity of workers is below the level of the minimum wage, the employers may decide to dismiss (if employment protection measures allow it) or not to hire new staff. If the minimum wage is set at a higher level, the negative consequences are greater in terms of employment opportunities for people with low productivity, especially young people and those with low education. They may be included in unemployment and / or may be excluded from the formal labour market and willing to accept employment in the informal economy. The presence of active employment measures tend to reduce these effects of the minimum wage as they offer redundant workers the possibility (due to the higher salary level of productivity) to raise, by improving skills, the level of productivity to levels that allow minimum wage employment (Neumark and Wascher, 2003).

In Romania, the Romanian mentality that has conditioned from the inside our country's economic development has influenced the transition to the market economy, this being unprepared to face many challenges and new elements brought by the market economy (Dinu and Brateș, 2013):

- giving up state dependence to provide employment and to obtain income;
- changing consumer behaviour as a result of growth and diversification of goods, which followed shortly after 1989;
- periods of social unrest amid economic restructuring, which involves understanding the importance of education and training for the access to employment;
- the social effects of transition, increased social inequalities and increasing poverty and vulnerability of groups generated particularly by the high rates of unemployment and declining purchasing power (and the erosion of savings);
- the possibility to migrate in the countries of the Western Europe.

In this regard, on the mentality of the population, we can mention the frequent wage claims with no coverage in productivity gains. The low levels of wages are the consequence of low productivity of the labour that remains at a very low level, although it recorded the highest growth rate in the period 2000-2010 in the European Union. However, productivity per person employed in 2013 amounted to slightly more than half the EU average (51.7%), although the progress is significant compared to 2001, when it was at the level of 23.5% over the same mean. The unions did not support the placement of workers in continuous training programmes to increase productivity as a prerequisite for wage increases, but on the contrary militated for increases in salaries uncorrelated with labour productivity growth and to maintain loss-making enterprises to avoid unemployment (the power of trade unions has been and remains high: the degree of unionization was 80.2% in 1991, 45.1% in 1998 and 32.8% in 2009 according to ICTWSS).

The minimum wage in euro at purchasing power parity varies considerably from country to country due to the differences in the quality of life, labour productivity etc.. It is between 1559E in Luxembourg and 354E in Romania. Levels below 500E also record the Baltic States, the Czech Republic and Slovakia.

In Figure 6 is shown the correlation between the minimum wage (Euro to PPS) and the level of labour productivity (per worker) in the year 2013. There is a direct correlation
between the two variables, countries with low levels of minimum wage also having low levels of labour productivity. Countries which are characterized by the lowest labour productivity and also the lowest minimum wage are Bulgaria and Romania, and those with the best results and the best correlation between productivity and minimum wage are Ireland, Belgium and France.

This aspect helps us to conclude that minimum wages are correlated with the level of productivity, so that the minimum wage is not a factor increased by the rigidity in the labour markets.

Figure 6. Correlations between labour productivity and minimum wage, EU, 2013

The low levels of minimum wages could fuel the vicious circles of low labour productivity because employees consider the wages unjustified for further efforts, either in work or in training and qualification. Thus, efforts to increase productivity encounter the strongest barrier, the human factor which is capable, when motivated to mobilize and effectively organize other factors of production.

6. Conclusions

The changes that have affected the economies of the world in recent decades determined by increased competition generated by globalization and integration in the European Union, by technological advance and the knowledge economy, have brought to the forefront of the labour market a new challenge, which is to tackle rigidities that affect the sound operation and resource allocation. The challenges that the labour market, workers and employers will have to answer are inequality of access and chances on the national labour market and becoming more global, discrimination and marginalization, exclusion and inequalities of all kinds. In this sense, all labour market mechanisms should be put in line with the economic realities and the need for smart, sustainable and inclusive growth (Europe 2020, European Commission, 2010).

Increasing the minimum wage produces contradictory effects. On the one hand it increases budget revenues due to increased tax base and, on the other hand, it increases non-wage labour costs for employers. When employers pay wages at the level of the minimum wage, the additional costs caused by increasing them may lead to either profit
reduction or higher prices for the final consumers or, in the worst case scenario, the lockout of the company. Each of these three possible answers to increasing the level of the minimum wage produces effects on budgets by lowering revenues and/or putting additional pressure on social protection systems in the case of business closure. Therefore, the policy of increasing the minimum wage and setting its size must be carefully managed to not generate adverse effects on budget revenues and employment.

References


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