

Iulian Boldea, Dumitru-Mircea Buda (Editors)
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THE LABOR MARKET AND THE MINIMUM INCOME IN ROMANIA

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Abstract: Badly calibrated social protection measures have perverse consequences, trapping the population in a veritable poverty trap. "Poorly calibrated" means simply "too high" relative to unskilled labor productivity and living conditions in rural areas. But it also means "granted to wrong people"; the incentive to fool the system is at high levels and the state lacks the ability and the incentive to discover and protect those who need social assistance most. In this paper we analyse the effects of minimum income and minimum wage on the labor market in Romania. We show that these effects depend on the number of children in the family, the existence of incomes from subsistence agriculture, the age of the workforce and other factors. International experience (US, Hungary) is also taken into account.

Keywords: Minimum income, minimum wage, unemployment, social protection, labor market.

Social protection measures are often badly calibrated, trapping the poor people in a veritable poverty trap. "Poorly calibrated" means simply "too high" relative to unskilled labor productivity and living conditions in rural areas. But it also means "granted to wrong people"; the incentive to fool the system is at high levels and the state lacks the ability and the incentive to discover and protect those who need social assistance most. To understand the unfortunate and unintended consequences of social protection measures, I propose to refer to two such measures: guaranteed minimum income and minimum wage.

The guaranteed minimum income is the sum of money that the family is entitled to receive from the state if it does not have any other source of income. If the family gets an income less than minimum wage, then the state offers the difference in the form of social assistance. Currently, the minimum income is established as follows:

- One person: 142 lei
- The family consists of 2 persons: 255 lei
- Family consisting of 3 persons: 357 lei
- The family consists of 4 people: 442 lei
- The family consists of 5 persons: 527 lei
- The family of 6 persons or more: 564 lei

To see the perverse effects of the minimum guaranteed income on the incentive to perform a remunerated job, let's take the example of a typical family with two children living

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in rural areas, where neither parent is employed and has no income and, consequently, receives social benefits amounting to 442 lei. In rural areas, this monetary income is increased primarily by in-kind income generated by work in your own household (cultivation of vegetable, livestock breeding). According to INS, income in kind provides practically 50% of the total income of the poorest 10% families in Romania. The families benefiting from the minimum guaranteed income fall into this group, so we can assume that, ultimately, for people working in subsistence agriculture the total labor income is actually double the amount received from the government. Then, these families can increase their income further by working as day laborers, because the activities of day laborers are not taken into account by public authorities in determining the household's net income. Through the undertaking of fiscal unregistered activities, such as construction and agriculture, the household's income continues to grow. Then the household receives from the state the family support allowance and other subsidies of lesser importance (eg, child benefit is added, in part, to the guaranteed minimum income).

Considering all these factors, we see that in many cases the total income (cash and in kind) of a family receiving the guaranteed minimum income probably exceeds 1,000 lei. A simple calculation shows that achieving this hampers the incentive of family members to take up salaried work - probably an unskilled job, at the minimum wage.

From 1 January 2015 the gross minimum wage was set at 975 lei (RON 724 net), its value being increased from 1 July 1050 lei per month (777 lei net salary). The difference between the minimum wage and minimum guaranteed income was until July 1st 282 lei, and is currently 335 lei. The difference continues to fluctuate due to variations of the two elements. However, without getting entangled in numerical details, the question that arises is the following: why would a family without wage income wish that one of its members to become employed if, in return for this effort, it's monthly revenue increase is only about 300 lei, while the opportunity cost of this change includes:

- the disutility of employment for a job with fixed schedule;
- Transportation costs to / from work;
- decreased work in the household and a consequently smaller income in kind;
- canceling the possibility to work as a day laborer and hence dropping any derived money income.

The discouraging effect on employment gradually grows with the number of children per family – the more children a family has, the smaller the difference between the minimum wage and the guaranteed income, so it is increasingly unlikely that one of the family members will look for a job.

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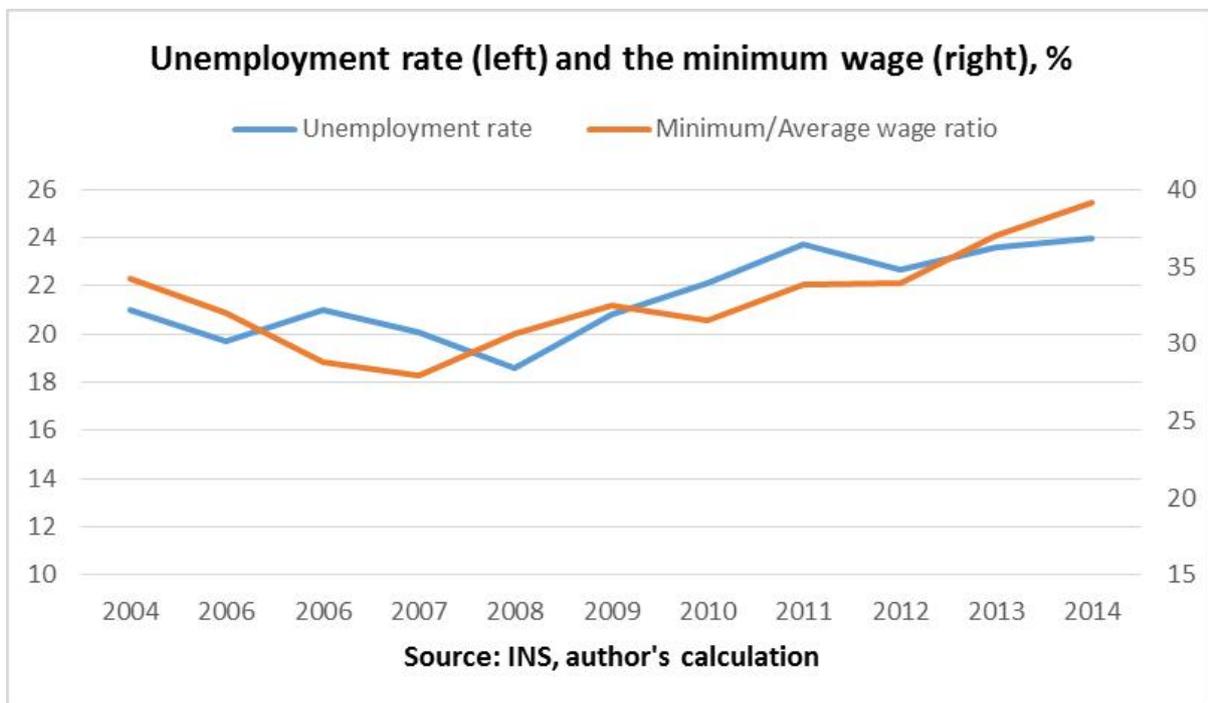
In this context it is perhaps not surprising that the number of families receiving the guaranteed minimum income has increased steadily in recent years, although Romania has registered a substantive economic growth during this period. It is also interesting that the amount paid from the budget to ensure the guaranteed minimum income has increased from 103 mil. lei in the first quarter of 2011 to nearly 175 million. lei in the first quarter of this year; a 70% increase in just four years.



Minimum wage and unemployment

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During the "Economics" class, students learn that the arbitrary setting of a higher price than the market price creates an imbalance: an oversupply compared to the amount required. One of the best case studies is the minimum wage - this giving rise unemployment. Perhaps raising the minimum wage is not the main determinant of unemployment in Romania, but this does not mean that contribute to its growth and especially increasing unemployment among disadvantaged groups. Intuitively, within the social group whose productivity is lower than the minimum wage and therefore will be excluded from the labor market is young people without work experience. The graph below illustrates the harmful effects of the minimum wage.



In the past 10 years the unemployment rate among young people up to 24 years - a social category particularly affected by minimum wage legislation, along with low-skilled workers, people with disabilities etc. - Fluctuated in hand with increasing the relevance of the minimum wage - judging the relevance of this threshold compared to the average wage. Reducing the importance of minimum wage overlaps the downward trend in the unemployment rate and raising the minimum wage after 2008 compared to the average salary is accompanied by lifting the unemployment rate (the trend is also present in 2014, but we have definitive data). Sure, it can be said that the drop in the unemployment rate in 2004-2008 is rather determined by overall economic growth but signaled role here only minimum wage. After 2008 minimum wage increase becomes increasingly burdensome for the labor market, the unemployment rate climbs too. Is it just a coincidence? Let's all just on account of the crisis? We recall crisis

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officially ended in 2010, we already scored 4 years of growth, but the unemployment rate among young people has not stopped rising.

The effects of minimum wage increases have been well noticed in Hungary, where a major policy experiment occurred. In the early 2000s the Hungarian government decided to double the minimum wage in two steps. In 2001 it operated its first rise from 25 000-40000 forints. The next year the minimum wage was increased to 50 000 forints. This episode has become almost a classic case study in literature, due to the magnitude of wage growth. Subsequent research has shown that “the hike significantly increased labor costs and reduced employment in the small firm sector; and adversely affected the job retention and job finding probabilities of low-wage workers. While the conditions for a positive employment effect were mostly met in depressed regions spatial inequalities were amplified rather than reduced” (Kertesi and Kollo, 2003, p. 1). Also, a different study argued that the increased burden of wages has been transmitted to consumers via inflation, at least in the case of firms facing an inelastic demand curve. „Passing through the effect of the minimum wage to consumers might be easier in some markets than others. We show that in markets, where a small increase in output price leads to a large loss in market level output (e.g. manufacturing and exporting sectors), firms pass-through the effect of the minimum wage to a lesser extent and the employment losses are larger” (Harasztosi and Lindner, 2015, p. 3)

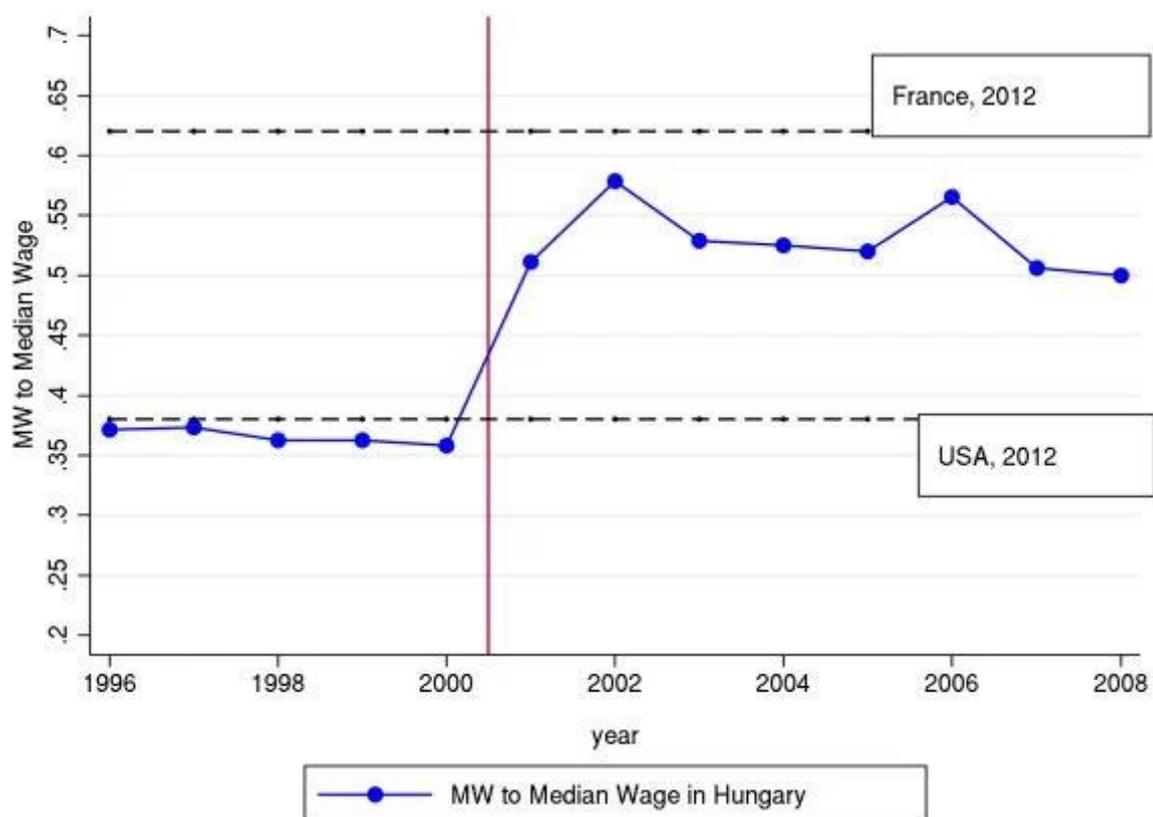
We can agree or disagree with the exact results of the minimum wage, but the iron principle of this measure remains: the minimum wage is good for some people, and bad for others. Raising the minimum wage is equivalent to extending the prohibition of work (for a certain wage level) and, in fact, amounts to an increase in labor taxation. Inevitably there will be some – exactly how many, it depends on the gap between wage and minimum wage equilibrium - who will lose their jobs. Among the losers of the minimum wage we will not find doctors, corporate employees, professors, or other white-collar workers, but weak productive workers and low wage earners. It is this segment of the labor force, relatively uneducated, without any important qualifications or even without any qualification (here comes the young and inexperienced), which will become unemployed as a result of this burden.

Thus, the minimum wage redistributes wealth from those who lose their jobs to the lucky ones whose pay increases (including well-paid people in the public administration, whose pay will increase because it is influenced by the minimum wage). Inevitably, inequality rises: the poor become poorer, the rich get richer.

The reality of the minimum wage is reflected in serious academic or professional analysis. For example, this is what Congressional Budget Office (Unites States) has to say about this measure:

„Increasing the minimum wage would have two principal effects on low-wage workers. Most of them would receive higher pay that would increase their family’s income, and some of those families would see their income rise above the federal poverty threshold. But some jobs for low-wage workers would probably be eliminated, the income of most workers who became jobless would fall substantially, and the share of low-wage workers who were employed would probably fall slightly.”

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Source: Harstoszi and Lindner (2015)

In conclusion, there is a solid basis for which we can surmise that social protection measures are not sufficiently sized to prevent harmful phenomena like unemployment or under-employment. Optimal social assistance must consider precisely the people who really need to be helped, minimizing the risk of perversion of incentives that lead to people entering the labor market.

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