THE ROMANIAN LABOUR MARKET ASSESSMENT AND CHALLENGES TO JOIN THE EURO AREA

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Abstract: *In this article, we are assessing how prepared is the Romanian labour market so far in the context of joining the Euro Area, by proposing as tool the labour market flexibility (LMF) meant by its definition, to absorb the economic imbalances. Among the determinants of the LMF considered in our analyse are the demo-economic structures, the employment rate, the unemployment rate, the wage flexibility, the working time and employment period, the geographic mobility, etc. The analytical approach is structured on studying the distinct features of the Romanian labour market compared to the other EU Member States in general and those in the Euro Area in particular that can induce different responses to the various adjustment levers in Romania, compared to the other states. The results our research highlight that there still are gaps between Romania and the other EU28 Member States, and therefore, reducing these gaps requires the promotion of measures / programs to stimulate investment in technology, as well as measures to protect the redundant workforce resulting from these investments and, implicitly, specific strategies and the ability to support the costs attached to them. Since Romania is no longer competitive in terms of the availability of adequate workforce, this in a wider context of the new challenges faced by the Romanian economy, with potential significant impact on labour demand architecture (digitization, industry 4.0, environmental compliance and sustainable development requirements, energy paradigm changes, etc.), which support the need to estimate the demand for labour and its quantitative and structural-qualitative characteristics, as well as strategies adopted by the state and companies to provide the necessary labour force. Therefore, a responsible wage setting policy is needed to ensure that overall wage dynamics are attuned to productivity developments and reflect prevailing conditions on the labour market, while the public administration and the private sector need to work closely together to improve the Romanian labour market before it becomes a major impediment to further economic development.*

Keywords: *Romania; Euro Area; labour market; labour market flexibility; demo-economic structures; employment / unemployment rate; wage flexibility; workers geographic mobility; labour and wage policy.*

JEL Classification: *F15; F20; F22; J11; J18; J21; J30; J51.*

1. Introductory Remarks and Theoretical Background

In the context of joining the Euro Area, due to the loss of the necessary leverage to adjust to the economic shocks (e.g. exchange rate, interest rate, etc.), the *labour market flexibility* (LMF) can become an important tool for absorbing the economic imbalances. Under these conditions, it is more than obvious that a high labour market

rigidity can be more expensive for a member of the Economic and Monetary Union (EMU) than outside it.
According to the theory of Robert M. Mundell (Mundell, 1961), in order to be optimal, a monetary union in addition to the common preferences of the Member States on economic policy objectives, it is necessary inter alia for each Member State to have sufficient flexibility of the domestic wages, as well as to provide the appropriate conditions for a high rate of labour mobility between the union`s Member states.
Various theoretical and programmatic developments of the subject have led to a much more complex concept of LMF that includes adequate demo-economic structures, an institutional labour market framework tailored to these desiderata, real wage flexibility, between Member States, flexibility in the degree and form of employment of labour resources, functional flexibility in close correlation with the ability to adapt quickly to skills and qualifications needs, etc.
In our analytical approach, we start from a UK HM Treasury study (HM Treasury, 2003) that defines the *flexible labour market* as ”one that has the ability to adjust to changing economic conditions in a way that keeps employment high, unemployment and inflation low, and ensures continued growth in real incomes. This applies whatever the monetary regime, but EMU puts a particular premium on certain aspects of flexibility, including that of wages” (HM Treasury, 2003, p. 10).
Among the determinants of the labour market flexibility considered are demo-economic structures, employment rate, unemployment rate, wage flexibility, working time and employment period, geographic mobility, etc. (see Figure 1).

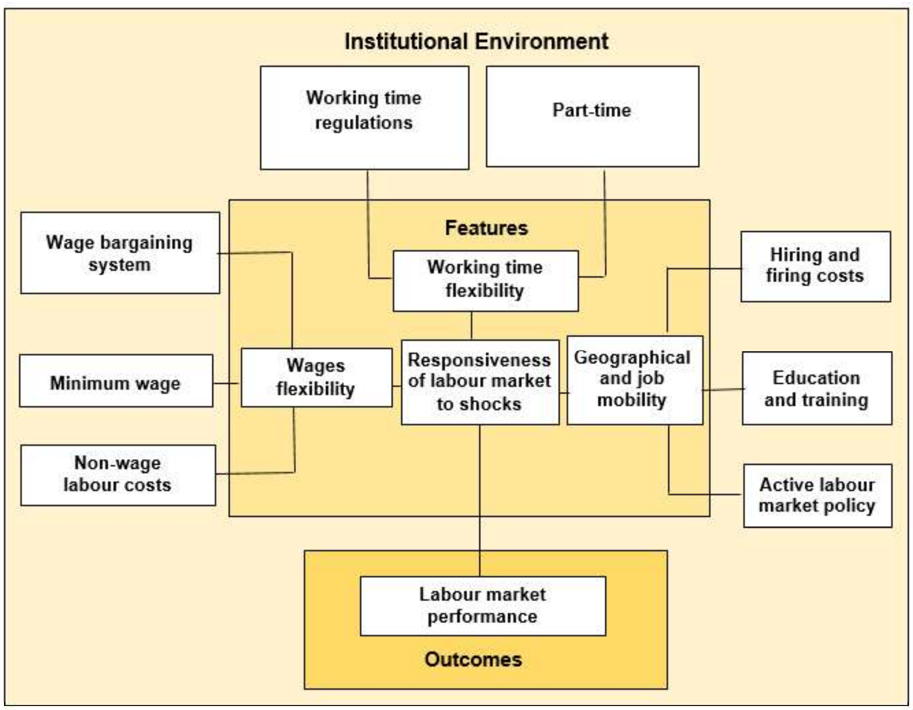

Figure 1. Determinants of labour market flexibility

Source: Soltwedel, Ruediger & Dohse, Dirk & Krieger-Boden, Christiane (1999). EMU Challenges European Labor Markets. IMF Working Papers, No. WP/ 99/ 131. 99. 10.5089/9781451855265.001, available on-line at the link https://www.researchgate.net/publication/45124536_EMU_Challenges_European_Labor_Markets/download, cited in HM Treasury (2003) *EMU and labour market flexibility*, EMU study, London, UK, p. 11, link http://image.guardian.co.uk/sys-files/Guardian/documents/2003/06/09/labour1.pdf, accessed on November 2017.

However, "labour market is not necessary to be flexible in all dimension, it is not fully possible. High flexibility in one dimension may help to compensate for low flexibility in another. A greater flexibility in each dimension will enable the labour market to operate more effectively and increase its ability to adapt to changing economic conditions. Labour market flexibility has also a beneficial impact on productivity, by supporting the more effective use of human resources within the economy." (Șerban, 2012, p. 4543)

2. Research Methodology and Hypothesis

The analytical approach is structured on studying the distinct features of the Romanian labour market compared to the other EU Member States in general and those in the Euro Area in particular that can induce different responses to the various adjustment levers in Romania, compared to the other states.

2.1. Persisting demographic decline. Growing trends of the demographic and economic dependency rates with an impact on the labour force substitution rate and on the sustainability of the budgetary balances

When grouping the 19 member states of the Euro Area by the evolution of natural, migratory and total population growth, four typologies of demo-economic behavior is emphasised. Using this methodological framework for the year 2017 (preliminary statistics data accessed on March 2018), Romania is included alongside Latvia and Lithuania in the group of states with total, natural and negative migration, while 3 of the states are characterized by total and natural negative growth and positive migration growth, other 5 states by total positive growth in the context of a negative natural growth but with a positive migratory growth, and for the other 7 states both the total, and the natural and migratory growth are positive (see Chart 1).
In the context of these developments, the *demographic dependency ratio* increased from 46.9% to 48.7% between 2002 and 2016 (World Bank, 2017), where: *Demographic dependency ratio = (Population aged under 15 + Population aged 65 and over) / (Population aged 15-64) * 100*, and according to the EUROSTAT (own computation based on data of the EUROSTAT, 2017 - *Demographic challenges — population projections: tables and figures*) forecast it will continue to grow to 52.3% in 2025 and 58.1% respectively in 2030.
These trends are due to the decrease in the *Youth dependency ratio* from 25.8% in 2002 to 22.9% in 2017 and the estimation of a further reduction of this indicator to 23.5% in 2030, where *Youth dependence rate = (Population aged under 15) / (Population aged 15-64) * 100*, and of an increase in the *Dependency ratio of elderly people* from 20.6% in 2002 to 26.6% in 2017 and the further increase of this indicator to 34.7% in the horizon of 2030, where *Demographic dependence ratio = (Population aged 65 and over) / (Population aged 15-64) * 100* (Chart 2) .

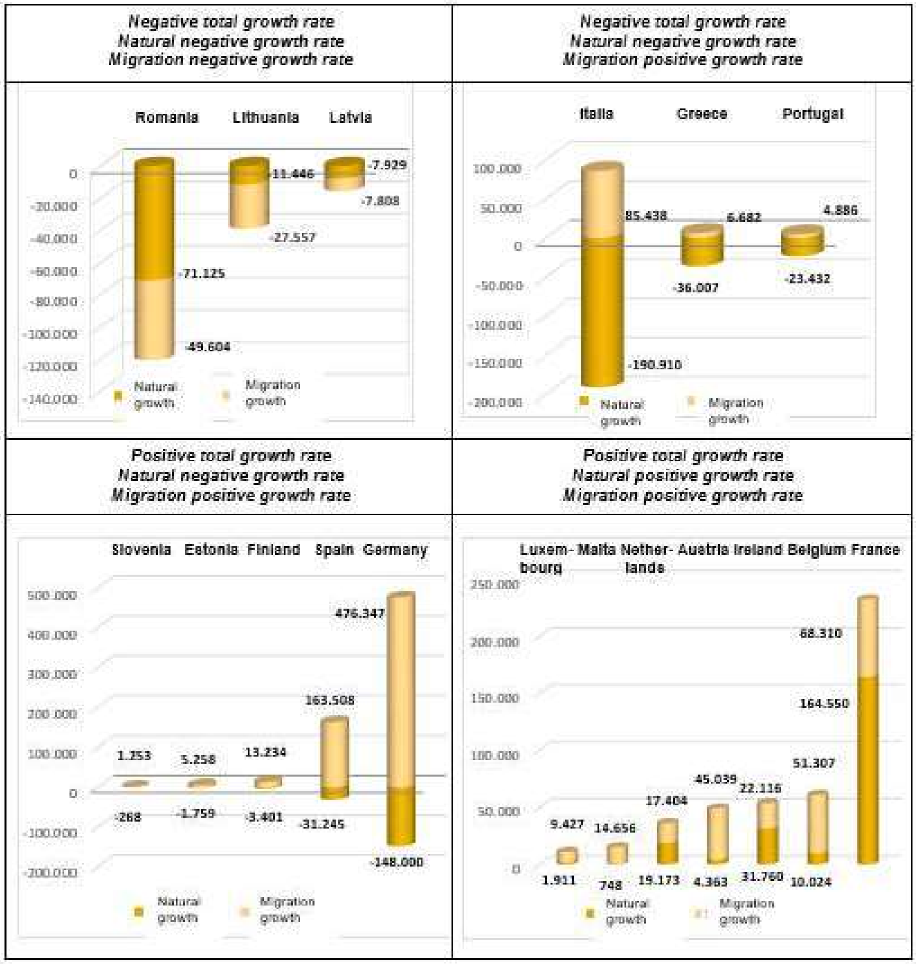

Chart 1. Natural and Migration Growth Rates in the Eurozone and Romania (2017 preliminary statistics data accessed on March 2018)
Source: Own computation based on the statistical data of EUROSTAT, *Demography and migration*, link https://ec.europa.eu/eurostat/web/population-demography-migration-projections/data/database, accessed on March 2018.

The *demographic dependence ratio* is doubled by a high *economic dependency ratio,* where the *Economic dependency ratio = (Inactive population + Unemployed) / Occupied population * 100.* In recent years, according to our own calculations of the *Economic dependency ratio* based on data released by NIS (National Institute of Statistics, Romania) – INS, AMIGO, *AMG1010 - INSSE - Baze de date statistice - TEMPO-Online serii de timp* - in Romania, on average, at an occupied person there were 1,2-1,3 inactive and unemployed persons (this rate was calculated for both the population aged 15 and over and for the population aged 20 and over). This level of

Economic dependency ratio is reflected in challenges in terms of labour force replacement rates and the sustainability of social security, health and unemployment insurance balances.

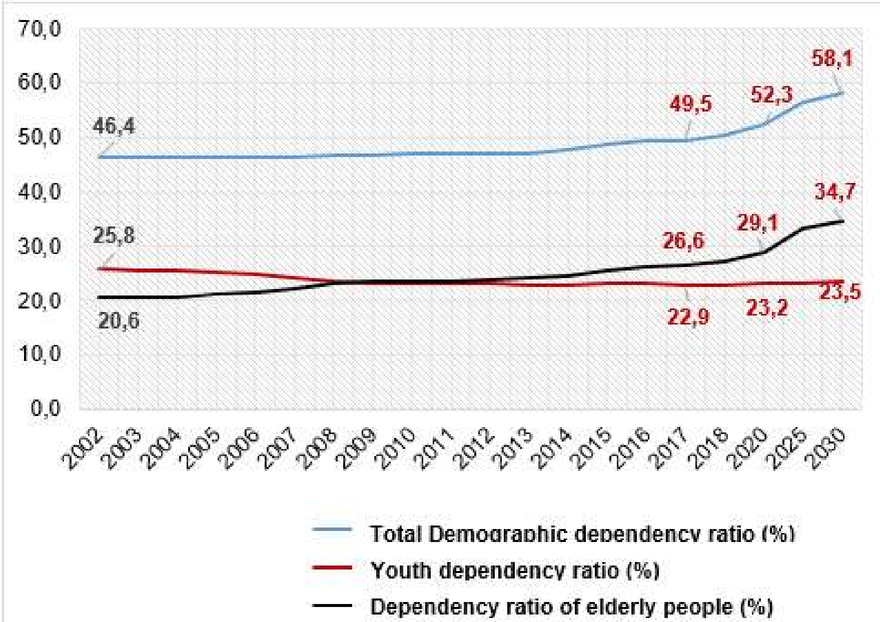

Chart 2. Demographic dependency ratio in Romania, between 2002-2016 and forecasts to 2030 (%)
Source: Own computation based on data of the EUROSTAT, 2017 - *Demographic challenges — population projections: tables and figures*, link https://ec.europa.eu/eurostat/statistics-explained/index.php?title=People_in_the_EU_-_population_projections#A_demographic_future_.E2.80.94_concluding_remarks, accessed on November 2017.

2.2. Characteristics of the employed population that differentiate Romania from the other Member States, with possible different response of the labour market to the specific adjustment levers

Although in recent years the employment rate of persons aged 15-64 has registered an upward trend in Romania, it is still at a lower level by about 3 percentage points compared to the average EMU 19 and by about 4 percentage points below the average level EU 28 (see Graph 3).
Against the backdrop of the external migration flow, during 2008-2016 the unemployment rate in Romania was below the average of the EU28 Member States and below the average of the EMU19 (EUROSTAT, *EU labour force survey (EU-LFS)*, accessed on November 2017). The unemployment rate of the under-25s is still high according to EUROSTAT database (2017) *Employment and unemployment (Labour Force Survey) (employ)*.

During the years 2015 and 2016 in Romania, consumer prices registered negative developments, while the period 2014-2017 is characterized by declining unemployment rates and low inflation (EUROSTAT, Harmonised Indices of Consumer Prices (HICP)).
These findings highlight the need of the Romanian economy for investment in human capital, the promotion of costly labour market measures to stimulate geographical mobility, to engage in dual education, etc. with effects on active employment measures and implicitly on public spending on employment.
An important role in striking a balance between flexibility and security on the labour market also rests with other regulations concerning wages and working conditions in the budgetary field, labour taxation, industrial relations regulation framework, regulations and practical results of collective bargaining , etc. (Dăianu, D., et all, 2016, p. 143)

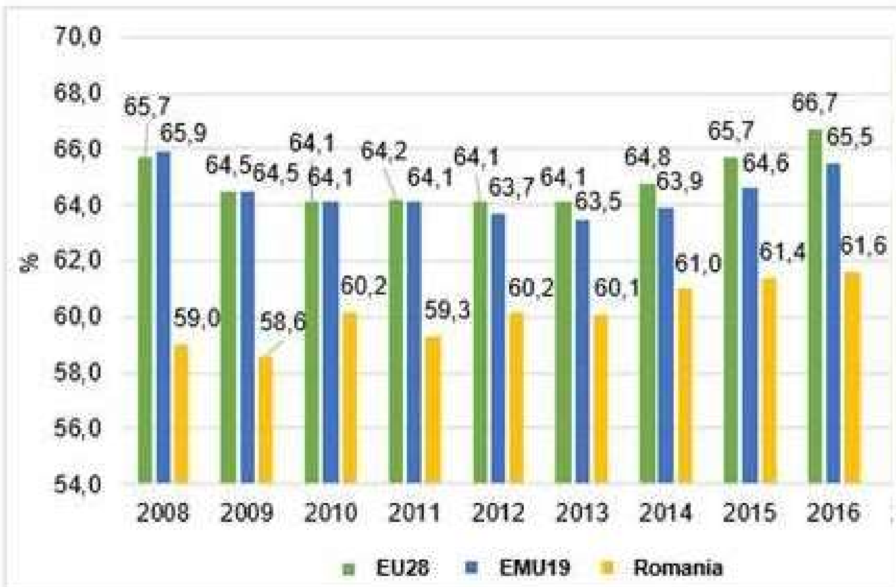

Chart 3. Employment rate of persons aged 15-64 in EU 28, EMU 19 and Romania, 2008-2016 (%)
Source: Own computation based on EUROSTAT database - Employment and unemployment (Labour Force Survey) (employ), accessed on November-December 2017.

Relevant in this respect is the synthesis by the authors of the study "*Romania and joining the euro area, under what conditions! / România și aderarea la zona euro, în ce condiții!*", based on the set of indicators provided by the World Bank in the framework of the program for evaluating the easiness of doing business in a certain country for 2015,"Easy of Doing Business". (Dăianu, D., et all, 2016, Table A3.7) The indicators used are grouped into four categories and measure with the help of a set of indicators deriving easiness / hardness, flexibility / rigidity of the work schedule, easiness / difficulty of making available, redundancy costs and job quality.

An important role in shaping the current framework of labour relations in Romania and the levers of flexibility in the labour market has also been the adoption of the new Law on Social Dialogue (Law 62/2011) in 2011.

The legislative reform achieved through this regulation had a negative social impact on social partnership, collective bargaining, and the quality of employment and working conditions.

Among the arguments in support of this statement, at least in the first years of law promotion, we recall that: following the reform, trade unions and employers' organizations faced considerable difficulties in effectively carrying out their functions; since the entry into force of the law, the number of trade union members has decreased, while many employers' organizations have encountered difficulties in acquiring representativeness under the new legal criteria; the reform has had a negative impact on the functioning of the national social dialogue institutions, one of the immediate consequences being the dysfunctionality of the Economic and Social Council (ESC); the regulation of working conditions through collective bargaining has significantly diminished, primarily through the abolition of the collective labour contract at national level which established a number of working and employment conditions, including the minimum wage at national level.

The cumulative effect of abolishing the collective labour agreement at national level, supplementing sectoral representation conditions, and introducing the absolute majority criterion for achieving representativeness for collective bargaining at company level was that over 1.2 million workers, particularly those employed in enterprises with fewer than 20 employees, have been excluded from collective bargaining, which may have a negative impact on wage levels and the quality of working conditions in general; due to the difficulty of obtaining representativeness for collective bargaining at the sectoral level, the social partners have concluded very few collective agreements at this level; they exist mainly in the public sector and according to the law, they do not contain salary provisions; the number of collective bargaining agreements at company level has diminished, the protection afforded by them has decreased compared to previous contracts and the number of covered workers has decreased significantly; in the absence of collective bargaining, the responsibility for regulating working conditions is largely the responsibility of the government, etc.

Difficulties in terms of regaining representativeness by social partners at all levels and conducting social dialogue and real negotiations restrict the active involvement of social partners in shaping sectoral, national strategies, in debating legislative initiatives, etc., all of which result in poor predictability of the impact of certain promoted measures, and sometimes in reducing the effectiveness of adjustment measures through flexibility-security balancing.

In close connection with these, an important part of the LMF is the quantitative one, reflected by the number of jobs created and dismantled in total and the causes of their creation or abolition.

Another aspect that deserves attention in the context of analyzing the effectiveness of leverage to promote flexibility is the relatively high proportion of employees in foreign-owned companies, generating exposure and vulnerability to relocation risk and sectoral / territorial imbalances.

In 2016, some 1.2 million people (29.8% of the employees of Romanian companies) were employed in companies with foreign capital. (”*Capitalul privat românesc 2016* - Ediția a II-a”, PIAROM & Ziarul Financiar, 2017)
By the share of these companies in the number of employees, the degree of exposure of certain areas and branches of activity to the risk of delocalization is relatively high.
In 2014, for example, in 11 branches of Romanian industry the share of employees in these categories of companies was over 50%, in the case of 9 branches between 30 and 49.9% and in 3 branches between 18 and 29.9%. (”*Capitalul privat românesc 2016* - Ediția a II-a”, PIAROM și Ziarul Financiar, 2017)
Similar situations are also recorded in a large number of small or urban localities where the share of employees in foreign companies is higher than 50%.
In a November 2017 analysis by the European Commission on Romania's net international investment position (NIIP), referring to the risks and vulnerabilities associated with net negative positions and their influence factors, it was mentioned inter alia that the stock of investments foreign direct debts represent a high percentage of external liabilities causing negative NIIP, a similar phenomenon being encountered in Estonia, Lithuania, Latvia, Bulgaria and Poland. (European Commission, 2017, p.10)

2.3. Income of the population with levels much lower than those in the other Member States, with multiple implications

Romania's lack of attractiveness for jobseekers from the other EU Member States due to low wages makes the attraction of labour from these states impossible to take into account, at least in the coming years, as a an important lever of LMF.
Although in the last decade, according to Eurostat data, the monthly minimum wage in Romania has increased, in terms of this indicator, Romania is on an antepenult place in the hierarchy of Member States with a minimum wage at national level, the only countries with lower minimum wages Bulgaria (260,76 Euro) and Lithuania (400 Euro). (EUROSTAT database, *Wages and labour costs: tables and figures*, link https://ec.europa.eu/eurostat/statistics-explained/images/e/e1/Wages_and_labour_costs_YB2018.xlsx, accessed on November 2017)
The share of the minimum wage in the average wage in the real economy, a synthetic indicator of wage flexibility, reflecting a wage development trend in the economy as a whole compared to the minimum wage, evolved in Romania from 31.3% in 2008 to 43.6% in 2016 (see Table 1).
Public wages have been raised significantly since 2015 - largely on an ad-hoc basis. The government has justified the increases as necessary to attract and retain high-quality staff in the public sector, in line with its priority to improve the quality and efficiency of public sector services. The reality is that for the time-being, the public sector leads wage determination in Romania, which implies that with the public sector as a leader, the wage setting policy should ensure that overall wage dynamics are attuned to productivity developments and reflect prevailing conditions on the labour market. Or alternatively, imprudent public wage policy carries the risk of triggering economy-wide wage dynamics that are inconsistent with productivity developments. An image of the degree of LMF through salaries can also be reflected by other synthetic indicators, i.e. the share of gross remuneration of employees and / or gross salaries in total value added in the economy.

Table 1. The share of the minimum wage in the average monthly salary in the real economy in Romania and other EU Member States in the period 2008-2016 (%)

Year EU Member State	2008	2009	2010	2011	2012	2013	2014	2015	2016
Slovenia	43,4	44,2	50,5	51,7	52,2	53,2	52,8	52,4	52,7
Lithuania	40,2	42,4	43,6	42,6	42,0	48,3	46,4	47,0	50,6
Luxembourg	n/a	47,8	48,6	49,3	49,5	50,4	50,3	49,5	48,9
Malta	50,6	47,2	47,4	47,8	46,7	47,5	46,9	48,0	47,8
Poland	39,1	42,2	42,0	41,7	43,5	44,6	45,3	45,5	46,3
Ireland	46,3	46,2	45,7	45,8	45,2	44,6	44,6	44,0	45,8
Portugal	44,2	42,8	42,4	42,2	42,9	42,7	44,1	43,7	45,4
Latvia	37,4	41,3	41,9	44,8	43,4	42,0	44,1	46,4	45,3
United Kingdom	38,2	38,6	38,7	39,1	39,6	39,3	40,2	41,0	44,1
Romania	**31,3**	**34,9**	**32,4**	**35,4**	**34,1**	**36,3**	**38,5**	**40,5**	**43,6**
Hungary	38,8	38,3	38,0	38,6	42,5	43,3	43,3	43,2	43,4
Netherlands	44,2	43,9	44,2	43,6	43,3	43,3	43,2	42,7	43,3
Bulgaria	40,6	39,1	36,3	35,5	37,9	39,2	40,5	41,0	43,1
Croatia	37,6	37,9	38,0	37,5	37,0	37,5	38,8	39,4	41,9
Germany	n/a	n/a	n/a	n/a	n/a	n/a	n/a	41,9	41,0
Estonia	34,8	36,4	35,5	33,5	33,0	34,1	35,9	37,2	38,3
Slovakia	33,6	35,7	36,0	36,1	35,6	36,0	35,4	36,9	37,7
Spain	37,6	37,6	37,8	36,7	36,4	36,1	36,0	35,6	36,0
Czech Rep.	35,0	34,3	33,3	32,4	31,6	32,6	32,8	34,4	35,5
Belgium	0,5	0,5	0,4	0,4	0,5	0,5	0,4	0,4	n/a
Greece	48,9	46,6	43,4	56,4	n/a	n/a	n/a	n/a	n/a
France	46,5	47,0	46,5	46,2	47,1	46,9	46,4	46,1	n/a

Source: Own computation based on EUROSTAT database, *Wages and labour costs: tables and figures*, link https://ec.europa.eu/eurostat/statistics-explained/images/e/e1/Wages_and_labour_costs_YB2018.xlsx, accessed on November 2017.
Legend: n/a = not available

In close correlation with wage levels and the low level of all other income, EUROSTAT statistics places Romania at the top of Europe in terms of poverty and the poverty rate. (EUROSTAT database, *Wages and labour costs: tables and figures*, link https://ec.europa.eu/eurostat/statistics-explained/images/e/e1/Wages_and_labour_costs_YB2018.xlsx, accessed on November 2017)
These factors fuel the inclination for external migration, and the lack of these services is, along with the level of salary, among the factors that influenced the decision to leave Romania to work in another EU member state, but also the lack of employees' for internal migration to areas with poor service provision.

2.4. Significant productivity gaps compared to other countries

Although since 2008 the gaps in labour productivity between Romania and the average of the EU28 Member States have fallen by about 15 percentage points, they remain at a high level. In 2016, labour productivity in Romania accounted for 61.9% of the EU28 average (see Table 2).

Table 2. Productivity of average work per person employed and hour worked (%, UE28 = 100)

Year / State	2008	2009	2010	2011	2012	2013	2014	2015	2016
Ireland	130,3	134,8	141,6	144,4	146,8	142,7	146,5	188,5	185,5
Luxembourg	169,5	162,7	162,5	166,3	162,1	163,3	169,9	168,2	163,2
Belgium	128,0	129,4	131,1	129,6	130,5	130,0	130,3	130,0	129,3
Austria	117,4	117,6	115,3	115,6	117,5	116,8	116,3	117,5	116,5
France	116,3	117,3	116,9	116,6	115,0	116,3	115,7	115,2	114,8
Denmark	107,6	109,5	115,2	114,6	114,4	115,2	115,3	114,3	111,9
Sweden	118,0	116,0	116,6	116,1	116,0	113,8	113,2	114,1	113,6
Netherlands	119,5	116,8	114,6	113,3	113,0	114,9	113,1	112,4	111,6
Finland	115,7	113,2	112,5	112,4	109,3	108,1	107,3	107,6	108,7
EMU19	**108,4**	**108,5**	**107,8**	**107,7**	**107,1**	**107,2**	**107,3**	**107,2**	**107,0**
Italy	114,7	114,7	112,7	112,0	109,9	108,5	107,1	106,1	107,3
Germany	106,7	104,0	105,0	106,3	105,1	104,5	106,4	106,1	106,3
Spain	100,7	105,3	101,8	101,1	102,9	103,2	103,2	102,0	101,8
EU28	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**
United Kingdom	106,1	104,1	104,0	102,2	102,6	102,3	102,0	101,5	101,3
Malta	93,1	94,0	94,7	91,2	90,4	89,6	91,2	95,1	95,5
Cyprus	94,9	95,2	91,5	89,9	88,7	86,7	84,9	84,8	84,3
Slovenia	83,6	80,0	79,5	80,7	80,1	80,4	81,4	80,7	80,7
Slovakia	79,2	79,0	83,4	81,4	82,3	83,5	83,8	82,5	81,6
Czech Rep.	77,7	79,1	77,1	77,4	76,1	76,6	79,1	79,7	79,8
Greece	98,4	98,0	89,6	85,5	85,9	86,9	86,2	83,1	80,9
Portugal	77,4	79,4	79,8	76,4	76,7	79,6	78,8	78,2	78,0
Poland	61,9	65,2	70,0	72,6	73,9	73,7	73,5	73,9	74,1
Lithuania	64,9	61,1	67,1	71,2	72,9	74,0	74,5	73,2	72,0
Estonia	66,0	66,6	70,6	72,0	73,2	73,2	73,7	70,9	71,8
Croatia	70,5	68,5	67,3	70,2	72,4	73,5	70,7	70,2	71,3
Hungary	70,5	72,4	73,0	74,1	72,8	73,1	71,1	69,8	67,8
Latvia	56,1	56,1	58,8	61,4	62,9	62,4	64,4	63,8	64,8
Romania	**51,2**	**51,3**	**50,6**	**51,5**	**55,6**	**56,0**	**56,5**	**58,6**	**61,9**
Bulgaria	39,3	39,4	41,3	42,2	43,5	42,9	43,8	44,1	45,4

Source: Own computation based on nominal productivity published within the EUROSTAT database, *Wages and labour costs: tables and figures*, link https://ec.europa.eu/eurostat/statistics-explained/images/e/e1/Wages_and_labour_costs_YB2018.xlsx, accessed on November-December 2017.

As above shown, wages in Romania are low relative to the rest of the EU28 and they are expected to continue growing faster than the EU28 average as the economy catches up. However, wage growth needs to be commensurate with productivity gains. Overall, in Romania the increase in real compensation per employee was broadly in line with that of labour productivity between 2011 and 2016. In 2016, however, wages started to race ahead of productivity, and this way, the public sector raising wage policy could affect economy wide wage settlements in a number of ways. Sharp increases in wages in the public sector, which accounts for almost 20% of employees, could provide a strong signal to private sector wage-setting (demonstration effect). Higher wages could also attract private sector employees to the public sector, forcing private companies to increase wages, particularly if the labour market is tight. Competition by the government for the hiring of educated and skilled employees could also create tensions in particular segments of the labour market. Overall, a substantial impact of public sector wage hikes on private sector wages will tend to weaken the link between wages and productivity in the latter.

3. Conclusions

There still are gaps between Romania and the other EU28 Member States and reducing these gaps requires the promotion of measures / programs to stimulate investment in technology, as well as measures to protect the redundant workforce resulting from these investments and, implicitly, specific strategies and the ability to support the costs attached to them.

Economy-wide real wage growth in Romania has been accelerating since 2015. Overall, the increase in real compensation per employee was broadly in line with that of labour productivity between 2011 and 2016. Already in 2016, however, real compensation started to race ahead. Therefore, a responsible wage setting policy is needed to ensure that overall wage dynamics are attuned to productivity developments and reflect prevailing conditions on the labour market.

Since Romania is no longer competitive in terms of the availability of adequate workforce, this in a wider context of the new challenges faced by the Romanian economy, with potential significant impact on labour demand architecture (digitization, industry 4.0, environmental compliance and sustainable development requirements, energy paradigm changes, etc.), which support the need to estimate the demand for labour and its quantitative and structural-qualitative characteristics, as well as strategies adopted by the state and companies to provide the necessary labour force. Therefore, the public administration and the private sector need to work closely together to improve the Romanian labour market before it becomes a major impediment to further economic development.

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