

The Impact of the Crisis on Wages in South-East Europe

Editors: Verena Schmidt and Daniel Vaughan-Whitehead

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Preface

Looking at the economic and financial crisis in global terms, the unprecedented increase in unemployment and very high levels of poverty which it caused have persisted long after the crisis peaked. Unemployment has increased to 210 million globally, the highest level ever recorded. The ILO estimates that, even if an economic recovery were to take hold, a global jobs crisis could still linger for six to eight years. In addition, the world is also experiencing increased oil prices due to social unrest in North Africa and the Middle East which will have adverse effects on economic recovery.

The 2011 “A New Era of Social Justice” Report of the Director-General to the International Labour Conference emphasises that labour productivity is running ahead of wage increases in a large number of countries. In developed countries labour productivity grew roughly twice as fast as wages. This implies a falling wage share, with direct implications for aggregate demand globally. The “World of Work Report 2011” by the International Institute of Labour Studies at the ILO suggests that by ensuring a closer connection between wages and productivity, the global deficit in demand would be addressed. In its Global Wage Reports for 2008–09 and 2010–11 the ILO called for the urgent adoption of a jobs-and-income based growth strategy to bring the global economy back on track. It noted that wage policies can play an important role in fostering sustainable economic growth by increasing domestic demand, and that social justice goals must be central in framing macroeconomic policy.

The impact of the crisis on wages has been important in all parts of the world and especially so in South-East Europe, where paychecks have been particularly affected. The ILO Global Wage Report 2010–2011 shows that the largest impact of the global economic and financial crisis on wages can be seen in Central and Eastern Europe and Central Asia, where annual real wage progression changed from double digit growth before the crisis to nearly zero or even negative growth for some of the countries during the crisis. This volume also shows that a number of countries in South-East Europe have been affected by wage arrears, wage freezes, informal wage payments, and an increasing number of low paid workers, which has contributed to widen the wage gap between those at the top and those at the bottom of the pay distribution. Current budgetary policies and public sector adjustments may bring new sources of income and wage inequalities.

This volume is based on empirical evidence from seven country studies in South-East Europe. It reviews the relationship between wage institutions, wage developments and wage policy responses in the region between 2000 and 2011. It identifies, in particular, the effects that the crisis has had on wage trends, and also the aggravating impact that some policies – such as freezing the minimum wage, tax reforms, budgetary cuts – may have had on these trends. It also highlights how social dialogue could help reach a better policy mix and more balanced employment and wage outcomes.

We hope that this volume contributes to the knowledge base on the wage impact of the crisis in South-East Europe and to designing and implementing more effective wage policies.

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Comparative Overview

1

Wage trends and wage policies in South-East Europe: What impact of the crisis?

VERENA SCHMIDT AND DANIEL VAUGHAN-WHITEHEAD

1 | Introduction

After recovering from social unrest and war, most countries in South-East Europe experienced economic growth and rising wages from the mid-1990s until the economic and financial crisis, which began in 2008. Some countries that were closely intertwined with global trade and foreign banking systems, such as Hungary, were hit by the crisis at the beginning, while others – such as Albania and the former Yugoslav Republic of Macedonia – experienced it a little later. This overview chapter offers an assessment of the impact of the recent financial and economic crisis on wage trends and wage policies in South-East Europe.

The analysis focuses mainly on the Western Balkans, namely Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Serbia. In addition, three new neighbouring EU member states – Bulgaria, Hungary and Romania – are examined for a comparative perspective. Together they form what will be called South-East Europe in this volume.

This chapter is divided into three main parts. First, it offers an overview of the wage institutions and wage-fixing systems prevailing in South-East Europe before the crisis. Second, it tries to identify the impact of the crisis on wage trends. Third, the chapter highlights and compares the different wage policy responses developed since the beginning of the crisis and presents some key policy issues.

2 | Diverse wage institutions

Overall, wage institutions in South-East Europe are still fairly weak. Moreover, they have been further weakened by the crisis in terms of collective bargaining, minimum wages and other formal wage-fixing mechanisms. The new EU member states have more institutionalized forms of wage bargaining, partly as a result of EU requirements on social dialogue and social policy in general.

2.1 | Social dialogue and wage bargaining systems

While almost all countries in South-East Europe have some sort of collective bargaining, their industrial relations mechanisms are not equally well developed or set up in the same way. Generally, they are either based on a centralized system – at national and sometimes also entity level – or decentralized further down at the sectoral or enterprise level.

TABLE 1.1 | WAGE BARGAINING SYSTEMS IN SOUTH-EAST EUROPE

Predominantly national level	Also at entity level	Predominantly sectoral level	Predominantly enterprise level
Romania (until 2011): Extension of national collective bargaining agreements to all workers by law. In 2011 Romania introduced a new Social Dialogue Law which makes collective bargaining at national level very difficult in practice.	Bosnia and Herzegovina: Wage bargaining at the Federation of Bosnia and Herzegovina and Republika Srpska levels. Bosnia and Herzegovina also have sectoral agreements for state-owned enterprises and privatized enterprises.	Albania: for the public sector. Serbia: for public sector; other sectors: weak or non-existent coverage. The former Yugoslav Republic of Macedonia: for the public sector; and collective bargaining and some enterprise level agreements in the private sector.	Hungary: but with a low coverage of workers by collective bargaining agreements. Bulgaria: with elements of national and branch bargaining, generally weak coordination between the different levels.

Source: Authors' illustration.

Centralized-level agreements

In Romania, until 2011 national collective bargaining agreements were extended to all workers by law. Furthermore, there was a combination of collective bargaining at the branch and enterprise level. A collective labour agreement was negotiated at the national level on a yearly/multi-annual basis between employers' organizations and representative trade unions that set the general framework for similar negotiations in a branch.

In May 2011, the Government of Romania introduced a new Social Dialogue Law (Law No. 62/2011) which makes collective bargaining at national level very difficult in practice (Kyloh 2011).

The law provides two complementary pre-conditions to be met by the signatories in order to be able to register a collective agreement at sectoral level, namely:

- 1) the signatory employers' organizations should cover more than 50 per cent of the total workforce employed in the sector, and
- 2) the signatory trade unions should cover more than 50 per cent of the total workforce employed in the sector.

Once these conditions have been met, the collective bargaining agreement can be registered with the Ministry of Labour and the signatories can request the National Tripartite Council to approve its

extension to all workers and employers in the sector. Upon the Council's approval, the Minister of Labour shall issue an order of extension.

Given that these pre-conditions are extremely difficult to meet, it looks as if registration and extension of a sectoral collective agreement have become almost impossible.

Some agreements at the “entity” level

In the region, Bosnia and Herzegovina is the only country with predominantly entity-level collective bargaining agreements. Here, collective bargaining traces its roots back to the former Yugoslav system of self-management. However, the two Entities introduced their own labour laws in 2000, which were supplemented by separate general collective agreements. In both Entities, employers are free to form or join any employers' association, and employees are free to form or join any union. However, social dialogue is underdeveloped partly because of the embryonic state of the conventional private sector. According to the general collective agreement in the Federation of Bosnia and Herzegovina, all employers, public and private, are in theory bound by the provisions. However, disputes arise as to whether, and to what extent such collective bargaining is binding. In the Federation of Bosnia and Herzegovina, only some collective agreements are territory-wide. Meanwhile, a law passed in Republika Srpska states that agreements are mandatory for those employees represented in the negotiation process.

In practice, in both Entities the currently valid general collective agreements have economy-wide coverage, while branch collective agreements are limited largely to state-owned enterprises and privatized former state-owned sectors. Although it is generally understood that all employers are bound by the general collective agreements, effective coverage of the branch collective agreements outside the broadly defined public sector has been limited, especially in the private sector (World Bank, 2005). The large scale of the informal economy partly explains this poor impact and enforcement of collective bargaining. Payroll taxes and contributions are probably far more significant than collective bargaining in determining labour market outcomes in Bosnia and Herzegovina.

Predominantly sectoral-level agreements

In Albania, social partners determine wage levels through general and branch agreements. The requirement is that the negotiated wages should not be lower than the official minimum wage set by the Council of Ministers. The role of the National Labour Council, which was founded as an advisory body to the Government, has so far played only a minor role. Branch collective agreements are signed for specific sectors and apply to all employers and employees in those sectors as the minimum level for setting wages. These are relevant mostly for the public sector where they define in more detail the coefficients used to outline the basic price of labour for the specific post and category of worker. In 2010, salaries in the public sector were increased, but this was not the result of collective bargaining negotiations and followed a unilateral Government decision. Collective bargaining in the private sector is possible by law, but so far has been limited in practice.

A distinctive feature of the former Yugoslav Republic of Macedonia until 2009 was that wage negotiations were based on net wages rather than on gross wages. Wage setting there can be characterized as decentralized. Public sector wages are determined by sectoral collective bargaining while private sector wages are set predominantly through negotiations between the parties at the enterprise

level. Although wages in the public sector are determined through sectoral collective bargaining, there is a lack of knowledge sharing on the signed agreements. In public administration, wage policy and developments seem to be driven mainly by political considerations in the absence of an indexation formula.

In the private sector, none of the trade unions have so far fulfilled the legal representativity criteria to represent their members in the workplace – meaning that until mid 2011, new general collective agreements for the private sector could not be signed. In 2011, the Ministry of Labour and Social Policy proposed changes to the Labour Relations Law, after they were examined by the Economic and Social Council, that would recognize unions representing the majority of employees in a private sector enterprise. These Government provisions should unlock negotiations for a new general collective agreement in the private sector. Another reason for the low coverage of collective bargaining agreements in the private sector is the prevalence of micro and small firms in the economy.

Sectoral social dialogue also prevails in Serbia, where a general collective agreement was signed in spring 2008, but concrete wage negotiations were left to branch. However, many collective agreements in sectors outside the public sector have long since expired, with only two sectoral collective agreements signed in 2010: in construction and agriculture/food. Moreover, the period since 2000 is characterized by a gradual but steady decline in union strength, which is reflected in the diminishing coverage of workers and employees by collective agreements.

However, the new EU member states lack autonomous social dialogue. In particular, they are generally characterized by inadequate collective bargaining at the sectoral level both in coverage and content (Ghellab and Vaughan-Whitehead, 2003). This drawback forced the European Commission to insist, during negotiations on accession, to have the new member states develop autonomous collective bargaining at the sectoral and enterprise level (Ladó and Vaughan-Whitehead, 2003; Vaughan-Whitehead, 2003). Some of the new member states, particularly Hungary, have initiated and developed sectoral social dialogue committees. No doubt a similar priority should be set in South-East European countries in preparation for possible EU accession.

Predominantly enterprise-level agreements

Hungary has a predominantly decentralized system of wage determination with relatively few workers covered by formalized collective bargaining and agreements made outside the firm. However, wage bargaining at the enterprise level coexisted with national discussions/negotiations on wages in the Tripartite National Interest Reconciliation Council (OÉT) which was in place from 1992 to 2011. The Council annually negotiated the national minimum wage (at least until 2011) and also formulated recommendations on average wage growth which served as a framework for enterprise level wage negotiations. This multi-level experience was fairly unique in the region, although there was little evidence to show the extent to which wage recommendations issued nationally influenced enterprise-level wage trends. In July 2011, the Council was replaced by a National Economic and Social Council which includes employers, employees, NGOs, chambers and churches. The National Economic and Social Council can draft proposals on wages for the attention of the Government but does not have any decision-making power (Budapest Times, 7 July 2011).

Moreover, collective bargaining coverage shrank substantially during the transition era. The fraction of employees covered by industry-wide wage agreements decreased from nearly 30 per cent in 1992 to less than 10 per cent in 2002, while enterprise-level agreement coverage declined from 20 per cent in 1992 to less than 5 per cent in 2002.¹ Wage inequality in Hungary increased strongly and fairly steadily during the transition, except in 2001–2002 when the minimum wage doubling temporarily improved the relative position of workers at the bottom of the wage scale (Köllő, 2010).

Bulgaria is characterized by a fairly complex system of wage bargaining and, in practical terms, wages are set at three levels: national, branch and firm. Nevertheless, coordination among these levels remains weak. The role of the national level has been primarily to fix the minimum wage. While branch agreements are reached by consensus and can be extended to all firms by the Ministry of Labour, this option has rarely been exercised, thereby weakening the potential impact of sectoral bargaining. A change in wage-fixing mechanisms was implemented on the advice of the ILO by the “Pact on economic and social development of the Republic of Bulgaria up to 2009”, which was signed by the social partners and the government in 2005. The aim was to create – similar to the Hungarian experience – a link between wage negotiations at the national level and wage bargaining at decentralized levels. The social partners also agreed, at the same time, to set wages in accordance with inflation, productivity, competitiveness and taxation changes. Such coordination mechanisms need to be developed further because there remains a fairly weak link between wages and productivity.

2.2 | Minimum wage fixing

Minimum wage institutions are unequally developed in the countries covered by this book. In 2009, the Global Jobs Pact adopted by the International Labour Conference as a decent work response to the crisis, specifically called on governments to consider options such as minimum wages, that can reduce poverty and inequality, increase demand and contribute to economic stability (ILO 2009b). The Global Jobs Pact mentions that the ILO’s Minimum Wage Fixing Convention, 1970 (No. 131) can provide guidance in this respect. Five of the countries under study – namely Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Romania and Serbia – have ratified Convention No. 131, which includes guidance on minimum wage levels. The Convention states that the policy should be related as far as possible to national practice and conditions and in particular: (a) the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits and the relative living standards of other social groups; and (b) economic factors, including the requirements of economic development, productivity levels and the desirability of attaining and maintaining a high level of employment. While there is a statutory minimum wage in most South-East European countries, the former Yugoslav Republic of Macedonia stands out for not having yet put in place a minimum wage fixing system. However, tripartite discussions started in mid-2011 and will continue in 2012 on the possible introduction of a national minimum wage.

¹ All figures cited in this introduction are fully referenced in the subsequent chapters.

Most countries have a statutory minimum wage

In Albania, the minimum wage is set – after consultations of the tripartite wage committee within the National Labour Council – by a decision of the Council of Ministers at the national level, and it is compulsory for both public and private employees. At the same time, the minimum wage in the public sector is published regularly by the Ministry of Finance and serves as a benchmark for both the minimum wage and minimum social security contributions. While minimum wages have increased regularly since 1995, the minimum wage/average wage ratio has progressively decreased, from 53 per cent wage in 1995 to 47.7 per cent in 2007. Moreover, various studies have shown that the minimum wage is still not sufficient to ensure decent living standards for workers and their families.

In Bosnia and Herzegovina, the two larger Entities differed markedly in terms of minimum wage regulations and trends. In the Federation of Bosnia and Herzegovina, the minimum wage was set in August 2005 by the General Collective Agreement at a fairly high percentage of the average wage (50 per cent). In Republika Srpska a minimum wage was established for the first time in March 2006, but at a lower level, at 40 per cent of the average wage. In contrast to the Federation of Bosnia and Herzegovina, Republika Srpska also allowed a sub-minimum wage for young people (aged 15–24). However, the minimum wage in the two entities converged over time. Moreover, both cases have shown that the minimum wage did not have any detrimental effects on employment. The relatively high level of the minimum wage in Bosnia and Herzegovina did not deter employment growth in the country. In Republika Srpska the significant minimum wage hikes in early 2006 and later on failed to provoke any employment reduction. Indeed, the upward trend in employment, observable between 2004 and 2006, appears to have continued uninterrupted. At the same time, wage levels in the informal economy were found comparable to those in the formal sector so that minimum wage increases in the latter did not lead to a shift of employers to the informal economy.

Hungary introduced a statutory minimum wage in 1989, just before the change of regime. From 1992 until 2011 (with a four-year interruption), the minimum wage was negotiated annually in the tripartite National Interest Reconciliation Council and was legally binding for the whole economy. The minimum wage plays an important role in the budget as it is used as reference value for several welfare provisions and also serves as the minimum base for calculating social security contributions for the self-employed.

From July 2006, Hungary introduced a fairly original reform, where the minimum wage was differentiated by job-related skill requirements and work experience. Differentiation by experience however was abandoned on 1 January 2009 (Köllő, 2010).

During the past decade, the relative value of the minimum wage has changed considerably. At its introduction, the minimum wage amounted to 34 per cent of the average wage while in 2000, just before the two major hikes, it stood at 29 per cent, much lower than the EU average. In 2001–2002, the Government doubled the rate, which raised the minimum wage as a proportion of the average wage to 39 per cent and 43 per cent in 2001 and 2002, respectively. The increase in the minimum wage made it possible to reduce wage disparities and also to improve the situation of low-paid workers. At the same time, such sudden and large increase had some adverse impact on employment, especially in small and medium-sized enterprises (Köllő, 2010). As already mentioned, the Tripartite National Interest Reconciliation Council was replaced by the more general National Economic and Social Council in July 2011, where the wage-fixing process may be totally modified and may alter previous intense participation of social partners in it.

In Serbia, the minimum wage is negotiated between the Government and the representative workers' and employers' associations. Since 2005, it has been determined as a net hourly amount, and is also expressed in monthly equivalents and gross amounts, according to the decision made twice a year by the Tripartite Socio-economic Council. However, if no agreement about the amount can be reached, the Government makes the final decision. The minimum wage is low – generally below 40 per cent of the average wage – and enforcement is weak.

Bulgaria introduced a minimum wage in 1997. The objective was to gradually link the real minimum wage to economic development and thereby achieve better linkages with productivity, improve the situation of low-paid workers and stimulate wage levels in the economy. While between 2001 and 2007, the 80 per cent nominal wage increase had some effect on poverty reduction, the crisis exacerbated the position of low-paid workers. As 42.6 per cent of women are low-paid employees (compared to 37.4 per cent of men), the minimum wage can play a role to improve women's income situation.

In Romania, until 2011, the national minimum wage fell under the Government's responsibility after consultations with the social partners. It was expected to cover all employees, to constitute the starting level in wage bargaining and to ensure the subsistence minimum. However, despite regular increases since the mid-1990s, the minimum wage in real terms as of January 2009 had still not recovered its 1990 level. The minimum wage declined from 60 per cent in 1990 to 20 per cent in 1996, before jumping again – but temporarily – to 31 per cent in 2010. According to the trade unions, the minimum wage remains below the subsistence minimum.

According to the new Law on Social Dialogue (Law No. 62/2011) adopted in May 2011, the national minimum wage shall now be established by Government Ordinance after consultation with the newly created National Tripartite Council which is chaired by the Prime Minister and Minister of Labour as substitute. The National Tripartite Council further comprises the presidents of the national confederations of employers and workers, secretaries of states of all Ministries and a representative of the National Bank. It will be important to monitor what implications such institutional reforms will have on the minimum wage fixing process and on the involvement of social partners.

Lack of minimum wage

In contrast to the other countries under examination here, there is no statutory nationwide minimum wage in the former Yugoslav Republic of Macedonia. Instead, there is a statutory minimum floor for the payment of social contributions, which ensures only minimum contributions to social funds and provides a safety net for workers in the form of a pension. In addition, the Law on the Payment of Wages requires wages not to be lower than 50 per cent of the average gross wage in the branch. However, minimum wages can be established through branch collective agreements. Only a few branches, such as leather and textiles have set a minimum wage at slightly below 50 per cent of the average net wage in the branch. At 37 per cent of the average net wage, the minimum wage in the public sector is established through an agreement between the parties in the branch. The minimum wage was increased in 2007 by 10 per cent, along with the general wage increase in public administration. For Government employees there are no provisions for the automatic adjustment of the minimum wage in response to price developments. Instead, it is negotiated between the signatory parties. The minimum wage in some branches of the public sector was increased again in July 2009.

2.3 | Informal employment and wage practices

The informal economy plays an important role in the region. In Serbia the informal economy – together with the informalization of employment relationships – has increased considerably since the crisis began. In Bosnia and Herzegovina, around one-third of all employment is informal, mainly in agriculture. Young people are also disproportionately represented in the informal economy, particularly in the Federation. Also noticeable is the slight preponderance of males in the informal sector, particularly in Republika Srpska. Similarly, in the former Yugoslav Republic of Macedonia the size of the informal economy is relatively large, its share in GDP in 2004–2005 was estimated to be 36.9 per cent, a slight increase from the 34.1 per cent registered in the late 1990s (Schneider 2007).

There are also informal wage practices in the formal sector. Undeclared wages in particular are prevalent in all countries in the region and they mainly take the form of so-called “envelope wages” where employers officially pay (and thus declare) their workers the minimum wage that is then complemented by an extra wage paid in cash (not declared). This practice can have a significant impact on public finances and lead to a drain on tax and social contributions. It also has a negative impact on workers’ social security benefits and pensions. Sometimes, envelope wages are set up in agreement with workers, who in this way can also avoid the payment of some income tax despite a clear loss in future social security benefits. In the case of employers, the arrangement allows them to minimize their social security contributions and income tax. Such informal payments are sometimes justified by both workers and employers on the basis that the state social security system is ineffective, as for example, in Albania. Sanctions exist, but are very low. Sometimes, as reported by a Bulgarian metal working union, pressure is put on workers to sign new contracts which include lower basic pay and higher (informal) bonus payments.

In Serbia, the high proportion of workers paid exactly at the minimum wage suggests that undeclared wages are common, although there are no data on this. In the former Yugoslav Republic of Macedonia, undeclared wages in addition to the basic wage are relatively frequent in the private sector. Furthermore, data on wages give some evidence of the “bunching” of officially paid wages around the 65 per cent minimum base for payment of social contributions. This is especially the case in hotels and restaurants, agriculture and real estate.

TABLE 1.2 | MINIMUM WAGE SYSTEMS IN SOUTH-EAST EUROPE, 2011

	Countries
Statutory or national minimum wage	Hungary (since 1989) Bulgaria (since 1990) Romania (since 1991) Albania (since 1995) Serbia (since 2001) Bosnia and Herzegovina (since 2005)
No minimum wage	The former Yugoslav Republic of Macedonia (minimum social floor)

Source: Authors' illustration.

3 | The crisis: A definite impact on wages

3.1 | General economic slowdown

The financial and economic crisis has clearly affected South-East European countries. This economic slowdown is clearly due to reduced demand, especially from external markets, which has hit these export-oriented countries.

After experiencing very rapid and high economic growth since the early 2000s, many of the countries in the region faced a contraction of economic activity from the second half of 2008 and through 2009.

In Bulgaria, GDP growth at the end of 2008 diminished by 3.5 percentage points compared to the first quarter of the year, and the recession continued to grow in 2009. Between 2007 and 2009, the fall was nearly 5 per cent. The fall was even higher in Hungary, by nearly 7 per cent. In Hungary, exports fell by 21 per cent in 2008–09, despite the dramatic devaluation of the forint. Romania, after economic growth of 7.1 per cent in 2008, experienced a GDP decline of 7.7 per cent in 2009, and of 2.1 per cent in 2010. In Bosnia and Herzegovina, there was a contraction of 3.2 per cent in 2009 before a slight increase, below 1 per cent, in 2010. GDP growth was reduced from the fourth quarter of 2008 in the former Yugoslav Republic of Macedonia, after the fall in exports and remittances, and led to negative GDP growth for 2009 of 1–2 per cent. In Albania, too, although GDP growth remained positive, the fall in remittances from abroad – representing, on average, 1 billion euros per year – was another sign of the impact of the crisis on the Albanian economy, which led to falling investment and consumption. Similarly, the growth model in Serbia, fuelled so far mainly by remittances and FDI primarily from the proceeds of privatization, was also halted by the economic crisis. Serbia has since sunk into recession and GDP fell by 3 per cent in 2009 (year-on-year) before resuming growth in 2010 (+1.8 per cent).

The general worsening of the economic situation has provoked a trade deficit in some countries, along with a deteriorating balance of payments as in countries such as Bulgaria, Hungary and Serbia. Hungary, Bosnia and Herzegovina and Serbia have applied to the IMF and other organizations for loans to avoid financial collapse.

The contraction has been extended to all economic sectors, including the traditionally booming sectors such as manufacturing and construction for Bulgaria, where industrial output in 2009 decreased by nearly 20 per cent in comparison to 2008. Similar circumstances have occurred in tourism in Albania.

3.2 | Employment effects

Economic contraction has had an impact on employment in the countries under study, although in different ways. Generally, it has brought about an increase in unemployment, for example, in Hungary, Bosnia and Herzegovina and Romania. The effect on employment has not yet emerged as clearly in the former Yugoslav Republic of Macedonia. Generally speaking, we can report from the experts' studies that the bulk of the adjustment efforts called forth by the crisis have concerned employment, especially in Serbia. There has also been a direct expansion of the informal economy in some parts of the region, for example in Albania.

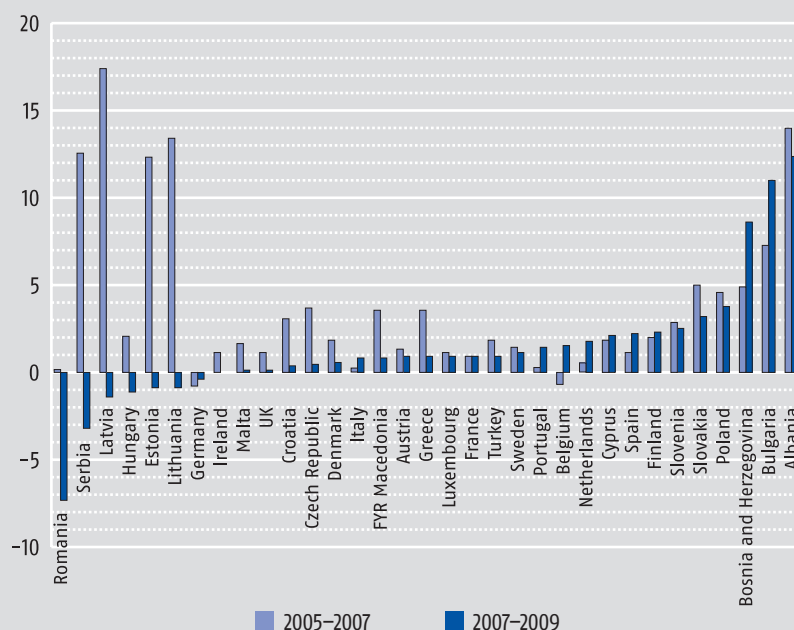
3.3 | Real wage trends

The ILO Global Wage Report showed that the crisis had a worldwide impact not only on employment but also on wages. Real wage growth declined by half on average during 2008–2009 while a certain number of countries even experienced real wage decline. In Central and Eastern Europe, real wage growth fell from 6.6 per cent in 2007 to 4.6 per cent in 2008 and –0.1 per cent in 2009 (ILO, 2010a, p. 7). In general, real wages at first started to grow less strongly and then even began to fall.

If we look at the South–East European region we can see that these countries have also experienced a definite impact on wages. This is reported in the different chapters of this book and also confirmed by data collected by statistical offices. The countries report slowing but still positive real wage growth in 2008, slipping into negative real wage figures in 2009, particularly in Hungary and Romania. In Hungary, there was a 3 per cent decline from the first quarter 2008 to the first quarter 2009, with some differences between the public – with a higher decline – and the private sector. In Romania, for the first time in the past decade, real wages also fell in 2008–2009 by more than 5 per cent, a trend that continued in 2010–2011. The fall was particularly strong in the public sector. Serbia also showed a decline in real wages in 2008–2009 according to the data used.

Other countries succeeded in maintaining a positive real wage growth in 2009, even if at a slower pace than in 2008, as for example in the former Yugoslav Republic of Macedonia. In the former Yugoslav Republic of Macedonia national statistics on the evolution of the average wage may not reflect the real situation due to a methodological change in the official collection of data, which saw an artificial increase of the average wages in 2008 following the integration of previous allowances in the basic wage. Real wages were found to have declined in 2009, even though real wages over the two-year crisis period had remained slightly positive. By contrast, real wage growth continued in 2009 in Bulgaria and Bosnia and Herzegovina but then started to slow down in both countries in 2010 due to the later arrival of the crisis.

FIGURE 1.1 | REAL WAGE GROWTH, 33 EUROPEAN COUNTRIES, 2005–2007 COMPARED TO 2007–2009



Source: ILO Global Wage Report database and authors' estimations.

At the enterprise level, severe wage cuts even in nominal terms were reported in Albania and the former Yugoslav Republic of Macedonia, where in 2009, several enterprises applied a provision of some branch collective agreements to reduce nominal wages by 20 per cent.

In general, the economic situation in the region has led to less generous wage increases in all sectors. In some cases this may be due to reduced working hours following the economic slowdown. Lower nominal wage increases have been somewhat offset by the slowing down of inflation so that the fall in real wages has so far been less severe than might have been the case if they had been accompanied by high price increases.

The evidence presented here and in the various chapters of this book confirms the decline in the real wage during the crisis. This certainly had an impact on both workers' purchasing power and their consumption and may have contributed to limit or delay the chances of economic recovery. This volume shows that consumption has consequently declined in many countries of the region.

3.4 | Wage arrears and informal wage payments

Apart from real wage declines, resurgence in the non-payment of wages and of wage arrears has also been reported in the region and specifically Albania and Bosnia and Herzegovina. Indeed, with regard to the latter, there are reports that, particularly in Republika Srpska, the recession has led to an increase in problems associated with the non-payment of social contributions and allowances, as well as the emergence of wage arrears. Although no empirical study is available, there appears to be a general understanding among workers' representatives and government officials that the recession has boosted activity in the informal sector, where the non-payment of wages is also widespread.

An increase in informal cash payments or envelope wages aimed at complementing the official wages of workers at the minimum wage level are also expected from employers in many countries in the region as a coping strategy to limit the burden of social contributions and reduce overall labour costs. Obviously, the non-payment of wages is not reflected in the official statistics. Similarly, the fact that many companies have put workers on unpaid leave – generally, low-paid workers – may have artificially inflated average wages, although this does not reflect higher take-home pay for the workers.

We should also emphasize that employment downsizing within the crisis – which has affected workers mainly at the bottom of the wage scale – could also lead to artificial increases in average wages. As a result, the reduction in average wages could, in reality, have been much more severe than what the official wage statistics suggest.

3.5 | The wage share

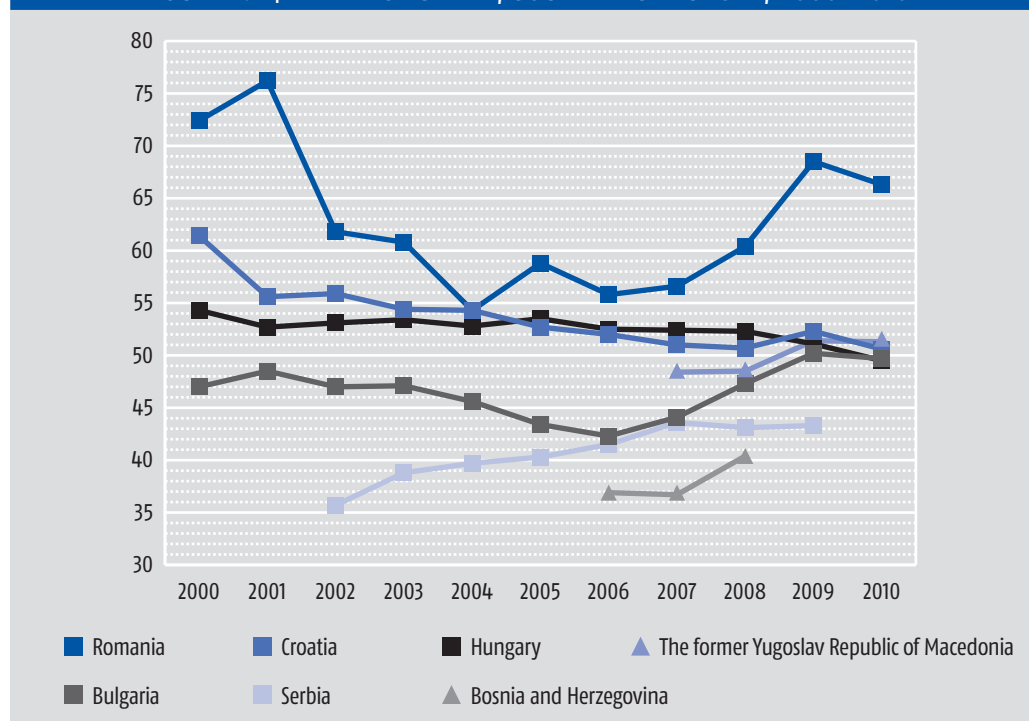
Various international studies have shown a long-term, worldwide decline in the wage share (ILO, 2010a).² Interestingly, it generally did not decrease in 2008, but had a tendency to increase, due to the significant collapse of GDP and a relative lag before wages were fully affected by the shrinkage of economic output. This is demonstrated by statistical figures (see Figure 1.2) illustrating a wage share change above zero in most countries in 2008–2009. While the wage share has increased across the South-East European region in this two-year period a fall was obviously expected after 2009, alongside the decline in real wages during the recession, and the lack of wage adjustments expected alongside with some signs of economic recovery of 2010–2011. This process has already been observed in some countries in 2009, such as Bulgaria, where the wage share started to drop from the second quarter of 2009, from 42 to 38 per cent. This was also seen in Hungary and Bosnia and Herzegovina from the first quarter of 2009.

Such trends were further confirmed in 2010. The wage share started to decline again in 2010, resuming its long-term downward trend, in most of the countries studied in this volume: Bulgaria, Hungary, the former Yugoslav Republic of Macedonia and Romania.

This evolution of the wage share during and after the crisis confirms results obtained on wage share trends in 2008–09 in other European and non-European countries (ILO, 2010a).

² In general terms, the wage share is defined as the ratio of employees' compensation to gross value added, both measured in nominal terms (ILO, 2010a).

FIGURE 1.2 | THE WAGE SHARE, SOUTH-EAST EUROPE, 2000–2010



Source: ILO Global Wage Report database.

3.6 | Minimum wage and low pay

Minimum wage trends have also been affected by the crisis. However, there have been two distinct responses within the region. Some countries have decided to either freeze or limit rises in the minimum wage generally under the announced objective to prioritise employment through reduced labour costs. Another group of countries decided instead to increase their minimum wages to protect the most vulnerable workers.

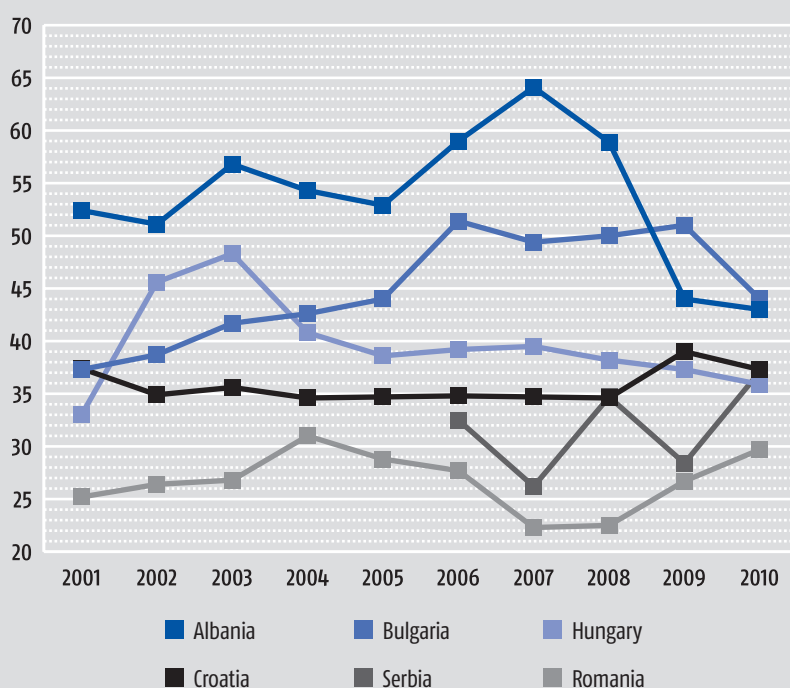
An indication of the evolution of the minimum wage compared to the average wage is demonstrated by the Kaitz index, which fell significantly in Albania and Bulgaria: in other words, the minimum wage fell relative to average earnings. In Albania, the crisis led to a further erosion of the minimum wage in comparison to the average wage, which had already started in the second half of the 2000s. The Kaitz index also decreased in Croatia and Hungary during the crisis. The Kaitz index increased only very moderately in Romania, but this was due more to the fall in the average wage rather than to a significant increase in the minimum wage, which remained below 30 per cent of the average wage.

By contrast, the minimum wage continued to increase in 2008–09 in Serbia: while in 2006 it represented only 21 per cent of the average wage it increased to 37.1 per cent in 2009, notably after a significant increase in January 2009 (by 11 per cent). However it then remained unchanged for the rest of the year, and also remained unchanged in 2010. By tradition, there is generally an adjustment of the rate in Serbia twice a year, in January and July.

Interestingly, the former Yugoslav Republic of Macedonia, which has no legal minimum wage, has experienced wage increases in some branch collective agreements in the public sector since the beginning of the crisis.

These trends must be analysed in a context of already existing and fairly low minimum wage levels in countries such as Bulgaria and Romania, where the lowest (below EUR 200) minimum wages in the EU27 prevail, and Albania, where the minimum wage remains below the family poverty threshold. In Romania, the proportion of low paid workers that already represented 50 per cent of the total labour force in 2007 has increased even further during the crisis, to 54 per cent in 2009. More generally, the crisis has aggravated the position of low paid workers, a situation which calls for a more active minimum wage policy in the future.

FIGURE 1.3 KAITZ INDEX (MINIMUM WAGE/AVERAGE WAGE), SOUTH-EAST EUROPE, 2001–2010



Source: ILO Global Wage Report database.

3.7 | New sources of wage disparity

Different chapters of this volume suggest that wage disparity may have increased during the crisis, from different perspectives.

Wage disparity between top and bottom

In several countries the crisis seems to have exacerbated wage disparity between workers at the bottom and those at the top of the wage scale in 2008–2010, partly because of the slow progress in the minimum wage. Some chapters in this book also show an increase in the Gini coefficient. Furthermore, in Romania the limited progression of the minimum wage has been accompanied by an expanding wage disparity between the workers in the top decile and those in the bottom decile over the past ten years.

Wage disparity between private and public sector

In general, wages in both the public and the private sector have been affected by the crisis, but clearly not to the same extent. The decline in real wages has been much more severe in the public sector – generally following government decisions to cut budgetary expenditures (including public employees' wages) to overcome the crisis (see Table 1.3).

In 2009, in Hungary, the difference in real wage growth was nearly 15 percentage points. Wages in the public sector experienced a sharp fall – of nearly 13 per cent – while real wages in the private sector continued to experience positive growth of 1.7 per cent, albeit lower than in 2008. Employment adjustments, however, were much greater in the private sector, while working hours were adjusted downward in the two sectors (by 3 per cent).

The fall in real wages was also generally higher in the public sector than in the private sector as for example in Bulgaria and Serbia. However, in Serbia the average private sector wage continued to grow throughout 2009 because more jobs were lost in this sector, particularly by people with lower earnings, which caused the average wage to increase artificially. Finally, in the most extreme case of Romania, public sector employees experienced a wage cut of 25 per cent in 2010 which was then followed by additional cuts in 2011. As a result, the wage gap between the public sector employees – generally better paid – and the employees in the private sector almost disappeared during 2008–2010, decreasing from 54 per cent in 2008 to 0 per cent in 2011. Such a large fall in public sector wages could not occur without having implications on the quality of the labour force and on public services.

TABLE 1.3 | EXAMPLES OF REAL WAGE GROWTH IN THE PUBLIC AND THE PRIVATE SECTOR, 2009

	Private sector	Public sector
Bulgaria	Q1 2009: 14.9 Q2 2009: –0.6	Q1 2009: 19.4 Q2 2009: –2.7
Hungary	Q1 2009: +1.7 Q2 2009: –1.4	Q1 2009: –12.7 Q2 2009: –4.4
Serbia	Q1 2009: –1.7 Q2 2009: –2.0	Q1 2009: +5.1 Q2 2009: +4.8

Source: Database of the Global Wage Report database (ILO 2010).

Gender pay gap

Overall, there are no comparative data in the region on the gender pay gap. Therefore, we can obtain only a rough indication of gender discrimination. All the data provided came from national statistical offices and cover the years 2000–08. Nonetheless, we can see that the highest wage gap between men and women exists in Bosnia and Herzegovina and Albania at around 35 per cent. In the former Yugoslav Republic of Macedonia, in the 2000–2008 period men's average net wages were 27.4 per cent higher than those of women, with the largest gaps occurring in agriculture, manufacturing, trade, hotels, health and social work.

In Serbia, the difference between the average hourly wages of women and men is 15–16 per cent. Here, in 1998, the gender pay gap – adjusted for education, experience, tenure, firm size, industry, industries' four-firm concentration ratio and the share of imports – amounted to 10 per cent in uncovered enterprises (that is, enterprises without a collective agreement) and 18 per cent in enterprises covered by a collective agreement.

In Bulgaria, the gender pay gap decreased from 31 per cent to 17 per cent between 1996 and 2006.

Since the beginning of the financial and economic crisis, in some countries – such as Bosnia and Herzegovina – women have withdrawn from the labour market on a larger scale. They have also frequently succeeded in keeping their job but under worse pay conditions. Women who are proportionally more present in the public sector have also been affected by the wage and bonus cuts in this sector.

Other sources of work inequality in the crisis

The crisis has also affected less protected workers who are generally hired on atypical contracts. Temporary workers have often been the first to be laid off on a massive scale (Vaughan-Whitehead, 2011), a situation which has further eroded their already low bargaining position. Significant wage differentials also continue to prevail between the informal and formal economies in the region, including Bosnia and Herzegovina and Albania.

Some evidence also points to a further increase in territorial wage disparity during the crisis, especially in large countries such as Romania.

4 | Wage policy responses to the crisis

All governments in the South-East European region have taken a number of measures in response to the crisis. Some involved financial reforms, while others were of a more general economic nature which directly influenced the labour market. Many of the responses have focused on overcoming or limiting the budget deficit and tended towards fairly restrictive policies in various areas of government spending, including wages.

4.1 | Budgetary cuts in the public sector

Budgetary restrictions on wage growth in the public sector have been introduced in most countries in the region. In Bulgaria, the anticipated growth in July 2009 in nominal wages financed from the

budget for a number of positions, including public administration, teachers and doctors, was halted. Furthermore, on the advice of the IMF the so-called “thirteenth month” wage in the public sector was abolished in Hungary, resulting in an eight per cent cut in the annual basic wage. Similar advice from the same international financial institution was given to Bosnia and Herzegovina, Albania and the former Yugoslav Republic of Macedonia. Meanwhile, in Serbia, there were further budgetary cuts and a significant reduction in the public sector wage bill in 2010, following the Government’s commitment to the IMF to freeze public sector wages and pensions in nominal terms in 2009 and 2010.

Also, in Romania, a unified wage law for budgetary personnel was introduced in September 2009, along with a list of anti-crisis measures negotiated with the IMF in exchange for a stand-by loan for the country. The purpose of the law in Romania was to produce a simpler, fairer, more transparent and less costly pay scale for public sector employees as well as a reform of the bonus system. However, the wage structure had still not been implemented in mid-2011. The measures so far have focused mainly on obtaining significant savings from the wage bill. In addition, budgetary restrictions for state employees were introduced in 2009–10 in the form of significant wage cuts, shorter working time and administrative leave.

Many governments have tried to accompany wage restrictions in the public sector with controls on wage progression in the private sector. This has been attempted in diverse ways, according to national wage-fixing specificities in the private sector.

4.2 | Two alternative routes with regard to minimum wages

Restrictive budgetary policies have also led many countries to freeze or concede only marginal minimum wage increases. In Bulgaria, for instance, the decision was made to freeze the minimum wage until mid-2010. Meanwhile, in Hungary, the minimum wage was not increased in the first half of 2009, despite trade unions’ demands for a 13.5 per cent increase following their assessment that a minimum wage of HUF 71,500 would be below the estimated subsistence minimum level (HUF 74,000).

Similarly, in Romania, the negotiations in 2010 and 2011 have led only to a modest rise in the minimum wage. In 2010, the minimum wage in the public sector was officially increased to 705 lei per month which came into force from January 2010 but due to budgetary constraints this increase was never put in place, and was postponed until the end of 2011. This increase was postponed until the end of 2011 due to budgetary constraints. Hence, the new level in the public sector remained similar to that in the private sector until December 2010. Furthermore, in January 2011, after negotiations, the minimum wage in the private sector was increased to 670 lei, while it remained at 600 lei per month in the public sector, in line with the government’s new restrictive wage policy. According to the trade unions, current minimum wage levels still do not cover the subsistence minimum level. This situation may only lead to a further increase in the already high proportion of low-paid workers, thus worsening the situation on the social side.

In contrast, a number of other countries raised the minimum wage in 2009, including Serbia, where it was increased by 11 per cent in January 2009, before being frozen with no adjustment in the second half of 2009 and in 2010.

4.3 | Other wage reforms

In the former Yugoslav Republic of Macedonia, several untaxed allowances (such as for food and transportation) that had been provided on top of the basic wage were integrated into the basic wage in 2009. The trade unions, however, complained that these allowances were being revised downward. Interestingly, a reverse process has been observed in Albania, where employees' representatives have insisted on negotiating additional non-monetary benefits for the workers because of the high levels of personal tax and social security and health contributions. In 2009, most collective agreements in the region have included provisions for non-monetary remuneration. This example shows again the close relationship between tax and wage reforms. It also highlights the need to complement wages – especially when they are so low – by additional sources of well-being.

4.4 | Working time

There have been a number of debates in South-East Europe on the promotion of work sharing and reduced working hours as a strategy to preserve employment during the crisis. In Serbia, the Ministry of Labour and Social Policy, in early 2009, launched a proposal for a job retention scheme to allow for government-subsidized shorter working hours as an alternative to lay-offs in the private sector. However, the idea has not borne fruit due to both a lack of funds and fears of potential widespread abuse. A number of major foreign-owned, export-oriented firms have started their own programmes of working hours reductions, but have not always been able to avoid layoffs.

4.5 | Changes in the tax system

A varied range of changes in the tax system were implemented in 2008–09. Albania kept its recently introduced flat tax rate although this tax seems to have deteriorated the relative position of low-paid workers. In Romania, the fiscal burden has increased, notably through an increase in social insurance contributions for both employees and employers. In Serbia, the IMF has also insisted on tax increases, including VAT. In the former Yugoslav Republic of Macedonia, tax reforms in 2009 included among other things the reduction of social contribution rates.

4.6 | Subsidies to preserve employment

In a number of countries, the government has provided grants or concessions with regard to the payment of social security/insurance contributions in order to reduce labour costs and thus stimulate employers' economic activity and preserve employment. This was done, for example, in Bulgaria.

Wage subsidies have also been granted to companies in Republika Srpska to help them overcome the economic crisis. A wage subsidy of KM 50 (around EUR 25) per worker per month has been provided in the sectors hardest hit by the crisis, such as textiles, leather and footwear, on condition that wages and social security contributions were paid in full by the recipients. This condition was aimed at preserving formal employment.

4.7 | Social dialogue

The economic crisis has also affected social dialogue, acting either as an opportunity or a threat. In some cases, the crisis has stimulated social dialogue to promote concerted solutions to concrete problems either through tripartism or collective bargaining. In the former Yugoslav Republic of Macedonia, discussions on strengthening social dialogue at the tripartite level took place to ensure a more comprehensive negotiating agenda and provide adequate protection for vulnerable and unorganized groups, including people on atypical work contracts.

In Bulgaria, there has been a tendency to move toward more centralized collective wage bargaining, with employers insisting on linking wages more closely to productivity and competitiveness. In response, trade unions have demanded the strengthening of the ties between wages, inflation and taxation. In some enterprises in the former Yugoslav Republic of Macedonia “concession bargaining” has occurred between trade unions/workers and management with the aim to reduce labour costs via wage cuts to preserve jobs in the short term. In other cases, enterprises have applied proactive strategies to reduce unit labour costs through improvements in the production process, work organization and/or innovations that enhance productivity.

Elsewhere, the crisis undermined social dialogue. In Bosnia and Herzegovina, a draft law included a provision allowing for the suspension of collective agreements in order to respect the restrictive wage policy requested by the IMF. However, in the face of opposition from workers’ representatives, this provision was withdrawn from the law passed under the title of “Law on the Implementation of Savings”.³

Interestingly, Serbia’s minimum wage increase in January 2009 must be seen as a form of compensation by the Government to the unions in exchange for an agreement to postpone the full implementation of the general collective agreement.

In Romania, employers’ organizations and trade unions have complained repeatedly that social dialogue reforms and the Labour Code reforms – including the latest reforms in 2011 – have been implemented without involving them. They issued a number of complaints to various bodies, including the International Labour Office. Generally in the region, public sector budgetary restrictions and wage cuts have been designed, passed and implemented by the Government with little if any consultations with the trade unions. Recent developments in Hungary with the dismantle of previous social dialogue institutions have also been seen as an attempt to reduce the previous role played by social partners in the decision-making process.

5 | Conclusion and policy issues

The crisis has revealed or further underlined a number of structural weaknesses in wage institutions and wage policies across much of the South-East European region. We underline below the potential

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Federation of Bosnia and Herzegovina, Official Gazette No. 52/09 (10/8/2009) in August 2009.

social and economic impact of the crisis on wages and some of the issues that could be addressed by governments and social partners.

A number of wage trends have been identified amidst the crisis in the present chapter and subsequent chapters. These trends have a number of direct implications for both social and economic developments. All studies confirm that the crisis has had a direct impact on wages. This includes slower growth or stagnation of real wages in a number of South-East European countries and the removal in some cases of non-monetary benefits that workers had previously enjoyed. Many bonuses such as seniority bonuses and even the thirteenth month benefit (in Hungary) have been cut. What is particularly worrying is the long-term increase in the proportion of low-paid workers and the growth in wage disparity between the top and the bottom of the labour market. This is precisely the kind of trends that contribute – as they contributed to the 2008–09 crisis – to bring about a financial and economic crisis in the first place. Moreover, wage moderation could jeopardize the economic recovery due to the absence of domestic demand and consumption. Finally, the evolution of the situation in the public sector may lead to a new source of inequality. Already, the significant wage cuts in the public sector in Romania, Bulgaria and other countries in the region appear to have reduced the wage ratio between the public and the private sector. This could lead not just to a fall in the quality of public services provided, but also possibly to a general decline (following cuts in education, and training programmes) of human capital in both the public and private sectors – even though this would be a key asset in helping South-East European countries to progressively build their competitiveness on the basis of higher value-added goods and production processes.

5.1 | Limiting the adverse impact of the crisis on wages

Impact on low pay and poverty: Stop neglecting social outcomes

The contraction of wages is obviously having an impact in the social sphere. Poverty remains high in the region. In Bulgaria, freezing all wage increases means that wages – especially in the public sector – will remain for some time at their pre-crisis (2008) level, which represents a serious drop in purchasing power. Moreover, this real wage decline should be seen in a context of the deterioration of other sources of income. Social transfers for pensions, unemployment benefits and social assistance have also tended to decline in Bulgaria, Romania and Albania. Trade unions have generally opposed such wage restrictions. In Bulgaria, for example, they launched a campaign against the minimum wage freeze, stating that this would reduce workers' purchasing power and thereby seriously limit domestic demand. Employers have generally welcomed restrictions to limit labour costs in the face of the serious difficulties they are encountering in maintaining employment; on the other hand they have been increasingly confronted to strikes and social tensions at enterprise level that have undermined their return to growth.

The risks of wage contraction undermining recovery: For a more balanced economic model

It may be beneficial to negotiate temporary work sharing, as well as wage subsidy schemes to prevent an enterprise from going bankrupt or implementing massive layoffs during a crisis. Workers and their trade unions have sometimes accepted concession bargaining, which has sometimes resulted in temporary wage cuts.

While a number of countries in the region have decided to freeze the minimum wage, there is very little empirical evidence that such a restrictive wage policy has a significant effect on preserving employment. On the contrary, a literature survey of the research in Europe revealed a lack of evidence of adverse effects of moderate and planned minimum wage increases on employment (Vaughan-Whitehead, 2010). Similarly, among others, a comprehensive study carried out in the United States on minimum wages in the restaurant sector also showed that minimum wage increases had no effect on employment (Dube et al., 2010).

With a period of low inflation, there are also fewer risks of an emerging price-wage spiral. However, one might wonder whether wage cuts during a crisis characterized by a collapse in demand in external and internal markets will not further reduce demand and thus exacerbate economic contraction. There are already signs of this in a number of countries in the region. In Serbia, for instance, aggregate demand in 2008–09 has fallen by a double-digit percentage on a year-on-year basis. Three-quarters of that fall was due to reduced domestic demand, mostly because of a curtailed availability of credit for both firms and households.

The real wage decline, which seems to be a general trend across the whole region, has certainly reduced consumption of products and services.

Alternative routes for wage policy

While companies require assistance during a crisis to preserve employment, wage policies should nonetheless be carefully calibrated. First, wage restrictions might indeed have some counterproductive effects on economic recovery. Also, wages' potential role with regard to demand should be highlighted, while the incidence of low pay should not be allowed to rise to avoid any massive effects on the social side. We should also recall that lower-paid categories of workers have a higher propensity to consume. A protective policy that hits the most vulnerable workers – notably through the minimum wage – can thus also have an important macroeconomic dimension. At the same time, it is important to better anchor wages to performance to enable them to play their full role in the real economy.

5.2 | An opportunity to carry out essential wage reforms

Limiting low pay and downward pressure on the minimum wage

Wage levels in many South-East European countries remain the lowest in Europe and often they are below the subsistence minimum. This is even more so for minimum wages. We see in the different chapters of this book that the ratio of the minimum wage to the average wage in almost all South-East European countries under coverage is below 40 per cent. Romania is, for instance, at 30 per cent. This is in contrast to the EU's recommended ratio of a minimum wage that is at least 60 per cent of the net average wage (Vaughan-Whitehead, 2010).⁴ The low level of minimum wages in the region is also surprising considering that almost all countries studied in this book have ratified the ILO's Minimum

⁴ Definition proposed by the Council's European Committee of Social Rights (ECSR) on the basis of Article 4 paragraph 1 of the Social Charter of the Council of Europe (Revised 1996). This threshold was also demanded by the European Parliament which has called on the EU Council to agree on a timetable for achieving the European minimum wage target in all member states.

Wage Fixing Convention, 1970 (No. 131) which clearly prescribes that their level should take into account the needs of workers and their families. It would thus be important to continue reforms to improve minimum wage fixing in light of Convention No. 131. First, countries without a minimum wage – such as the former Yugoslav Republic of Macedonia – should discuss the possible introduction of a minimum wage in order to establish a wage floor which would protect the most vulnerable workers. At the same time, minimum wage fixing mechanisms should be improved where needed. For instance, delinking social benefits from the minimum wage is a policy measure which can help to reduce – for instance potentially in Albania – the downward pressure on the minimum wage, and let it play its economic and social role. Finally, the level of the minimum wage should also take into account the needs of workers and their families, the general level of wages in the country, the costs of living, social security benefits and the relative living standards of various social groups. At the same time, economic factors should be taken into consideration, including the requirement of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment.

As proposed in the Global Jobs Pact (ILO, 2009b), the minimum wage should be aimed at reducing poverty and inequality, increasing demand and contributing to economic stability.

Wages and productivity

At the same time, some chapters of this book (for instance, on Albania and Bulgaria), have provided some elements which show how poorly wages are related to economic performance. While trade unions have complained about this in the periods of growth that characterized the 1990s, employers have criticized such a lack of correlation in the current context since they expect wages to react more systematically to economic contraction (for a review of the wage share behaviour in the crisis, see ILO, 2009a). This could lead policy-makers to consider implementing pay systems that link wages more closely to economic performance. Linking wages to productivity would allow wages to increase as soon as economic recovery takes place, while allowing some wage flexibility in periods of economic downturn to preserve employment. At the enterprise level, the introduction of profit-sharing or performance-related pay – that is, linking part of wages to performance – is also seen as an important tool to stimulate productivity and ensure that wages more accurately reflect enterprise performance.

Wages and tax reforms

The impact of tax policy on wages should also be taken into account. All tax reforms may affect net wages. The outcome for wage earners, especially those at the bottom of the income scale, is clearly less advantageous if the income tax is flat rather than progressive, and if even the lowest wages, close to the minimum wage, are taxed.

In many South-East European countries, the current structure of the labour taxation system (not only personal income tax but also social security contribution rules) seems both inequitable and inefficient.

Tax reforms in relation to personal income tax in Albania, for instance – where there is no progressivity in personal income tax after the introduction of a 10 per cent flat rate – have had a negative effect on the lowest paid workers. There is some evidence that it has also fed an increase in informal employment (72 per cent reported that their wages were informal), as recently reported in a survey carried out by the ILO in the construction sector (ILO, 2008b). A high relative tax burden around the minimum wage, which

is the natural point of entry into the formal economy, clearly reduces the incentives for workers to join the formal economy. It thereby also diminishes state revenues. The flat rate which is common also in several other neighbouring countries – such as Serbia – may have similar adverse effects on net wages and purchasing power. Any move toward more progressive taxation and a reduction in the tax burden for low-wage labour would bring improvements in fairness and social justice.

At the same time, expanding the formal sector should be a priority of tax reforms. Taxes should, for instance, be reformed to limit “envelope wage” practices and thus motivate employers to declare workers’ effective wage levels rather than only the minimum wage. As shown in Estonia, the increase in the statutory minimum wage has led to a reduction in employers’ use of envelope wages as it reduces the gap between the declared wage and the effectively paid wage (Vaughan-Whitehead, 2010).

Pensions are another area worth reforming. In Albania, the low level of pensions does not induce workers to declare their work in the formal sector, where they would pay contributions to their future pensions.

More systematic collection of wage statistics

Our study has highlighted a serious paradox. Collection of wage data and wage analysis remain fairly limited in most South-East European countries although wages remain the main issue of collective bargaining and represent a major part of employers’ labour costs and the main source of income for workers. Wage data are also essential for any tripartite or/and bipartite negotiations on wages and incomes policies.

In Albania, there are no wage data on the private sector. In Bosnia and Herzegovina, there is no breakdown of wage data by gender or by ownership (and no distinct wage data for the public and the private sectors), and no data on the wage distribution or on wage levels by different wage deciles – which impedes the calculation of wage differentials between workers at the top and those at the bottom of the wage scale.

Generally speaking, there are also no official calculations of the subsistence minimum or the poverty line in many countries in the region.

Across the board, information on collective agreements should be improved. In the former Yugoslav Republic of Macedonia, for instance, there are problems due to some signatory parties not submitting collective agreements to the Ministry of Labour and Social Policy, as required by law. This implies a lack of information available from the Ministry. A database of enterprise-level collective agreements represents a major necessity in all South-East European countries.

Strengthening wage bargaining

In several countries in the region, wage-fixing remains fairly centralized, which impedes the development of decentralized wage bargaining at enterprise and sectoral level. However, reforms are planned to change the current system. Changes are envisaged, for example, in the former Yugoslav Republic of Macedonia, where all wage coefficients are currently defined in each of the 15 existing branch agreements through a multiplier of the minimum wage. While the minimum wage should be used as a wage floor in the whole economy, it should be progressively complemented by wage bargaining at all levels that would effectively define and adjust wage levels.

The integration of previous allowances into basic wages, as recently done in the former Yugoslav Republic of Macedonia, may also help to simplify the wage structure and facilitate wage bargaining. At the same time, it is important that governments ensure that workers do not lose out from this shift in terms of purchasing power and living standards, nor in terms of progressive increases of the minimum wage.

Finally, the crisis has again highlighted the differentiated wage outcomes resulting from collective bargaining or its absence. Most workers in low-pay sectors continue not to be covered by collective bargaining, as in Bulgaria and other countries in the region, where most collective agreements are not extended to non-signatory firms. The coverage and effectiveness of social dialogue should therefore be improved to limit the number of low-wage earners.

As was shown in the Global Wage Report 2010–11, both collective bargaining and minimum wages can help to achieve a more balanced and equitable recovery by ensuring that working families and households with low wages obtain a fair share of economic growth (ILO, 2010a, p. 80).

Social dialogue to better adapt wage policy to the crisis

Tripartite discussions may help in seeking consensual solutions to the crisis and to channel economies of the region towards economic recovery. Although attempts have been made in several countries in the region, no much consensual outcomes could be reported. All important issues mentioned in this volume – such as income, wages, taxes and pension policies – should be debated at the national level.

The wage trends identified in this volume are worrying and will thus require continuous monitoring. In particular, the wage outcomes of the current budgetary adjustments will require attention. The implications of wage trends for economic growth and society as a whole also need to be analysed more systematically. In other words it is time for policymakers to take a more voluntaristic approach on wage policies and to do so in a comprehensive policy framework.

The experience reported through this volume demonstrates the need to analyse wage trends and define wage policies in the context of other types of policies – such as on social protection, taxes, etc. – and more globally, in close connection with the type of economic model that the countries in South-East Europe will choose to pursue in the next decade.

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The Impact of the Crisis on Wages in selected Balkan Countries

2 Albania: Urgent need for wage reforms

FILLORETA KODRA

1 | Introduction

Albania is a lower-middle income country. The transition from socialism to capitalism in the 1990s has proved challenging as successive governments have grappled with high unemployment, widespread corruption, a dilapidated physical infrastructure, powerful organized crime networks and combative political opponents. In the general elections held in June 2009, the Democratic Party (DP) and its allies won 70 seats in Parliament which was not enough to create a stable government. For the first time since the collapse of the socialist regime, a coalition with the participation of a left-wing party (the Socialist Movement for Integration) came to power to continue the reform process in preparation of an eventual EU membership. Other parties in the coalition include the Republican Party (RP) and the Party for Justice and Integration (EC, 2009).

Macroeconomic growth averaged 5 to 6 per cent in the period 2002–08, while inflation has remained low and stable (INSTAT 2009). Large-scale emigration has meant that high numbers of worker remittances, mostly from Albanians residing in Greece and Italy, make up 13–15 per cent of GDP (World Bank, 2009). Absolute poverty rates fell from 25.4 per cent in 2002 to 12 per cent in 2008, lifting roughly one-half of those who were poor in 2002 out of poverty in Albania. Furthermore, the extreme poverty rate decreased from about five to 3.5 per cent in 2002 and 2008 respectively, while inequality rose marginally.

During the transition, Albania has experienced strong growth performance (Iradian, 2007). This has been driven largely by manufacturing which accounts for more than 80 per cent of output growth (Iradian, 2007). However, despite these changes and improvements Albania remains far behind the average European economic indicators, with a GDP per capita equal to 6.5 per cent of the EU15 average (Albanian Demographers Association, 2007). With its current annual growth, Albania would need 40 years to reach the current average GDP per capita of EU countries. While Albania's cumulative real growth for the period 1993–2007 was 96.1 per cent, most of that came from total factor production (80.5 per cent) and capital growth (20.9 per cent), while the labour factor for the same period was –5.1 per cent (see Table 2.1).

**TABLE 2.1 | SOURCES OF GROWTH IN TRANSITION ECONOMIES, ALBANIA, 1993–2007
(IN %)**

	Cumulative real growth	Contribution to growth		
		Total factor production	Capital	Labour
Albania	96.1	80.5	20.9	–5.1
17 transition economies	49.8	49.0	4.8	–4.3
Of which: Baltic states	73.5	73.2	11.7	–11.1
CEE countries	51.3	45.6	8.7	–2.9
Poverty Reduction and Growth Facility (PRGF) transition economies	37.9	43.0	–5.9	–0.9

“Jobless growth” remains a regional problem but Albania stands out among transition countries for insufficient employment creation despite strong output growth. As economies in Central and Eastern Europe have stabilized and recovered following the difficult years of early transition from socialism, employment has to varying degrees lagged behind output growth.

Also, job creation growth in Albania may be low compared to GDP growth, but none of the neighbouring countries have had the economic growth experienced by Albania, where for instance services were especially strong in 2008 (World Bank, 2009) – although there was no net job creation in that same sector between 2001 and 2004. The most important barrier to job creation in Albania is the unfavourable business climate. Labour costs in Albania remain low relative to other countries in the region but they do appear to have grown significantly in recent years. Also, high payroll taxes that finance social insurance represent a disincentive for employment in the formal sector (World Bank, 2006). Compulsory social security contributions in South-East European countries account for about 19 per cent of GDP, while in Albania social security revenues only represent 4.4 per cent of GDP. This is not because of low contribution rates, but rather reflect Albania's very high rate of informality (Arandarenko et al., 2008).

2 | Some wage trends

2.1 | A lack of wage data

Before presenting the wage story and wage determinants, it is important to note that such an exercise is particularly difficult to carry out with regard to Albania because of the lack of available data on wages and incomes.

Data on wages are collected by three separate agencies: the National Institute of Statistics (INSTAT), the Ministry of Finance and the Ministry of Labour, Social Affairs and Equal Opportunities. INSTAT provides estimates for economy-wide average wages, including the self-employed, but it does not offer a full picture on wages outside the public sector. The Ministry of Finance conducts an annual enterprise survey to gather estimates on general average wages in the public and private sector and it is also the main direct source for information on public sector wages. While the Ministry of Labour, Social Affairs and Equal Opportunities provides some general wage data, it has no wage data on the private sector. The result is that the three wage estimates differ sharply.¹

2.2 | A public/private sector pay gap

Despite the lack of data the three abovementioned sources of information seem to converge, allowing us to report that public sector wages are on average 25 per cent higher than the overall wage in the economy including for the self-employed.

However, behind this striking public sector wage advantage is the widespread policy of double payrolls or “envelope wages” that exist in unregistered companies outside the public sector. Wages in the private sector should thus be higher than what the official data suggest. Formally, almost 60 per cent of all registered employees, that is, those who pay social security contributions, receive an income equal to the net minimum wage (ETF, 2006). Additional payments are generally paid in cash in an informal way.

2.3 | The minimum wage as a threshold

The relatively high proportion of minimum wage earners – even if inflated by tax evasion – shows the importance of the minimum wage as a threshold. This minimum wage has been regularly adjusted in the transition process without bringing inflationary pressures. This was not even the case in 2000–2001, when the minimum wage increased by 9 per cent, while inflation rose by 3.5 per cent.

As shown in Table 2.2, minimum wage rises have generally covered inflation, and have also been in line with average wage increases. The only exception occurred in 2007 when the minimum wage

¹ There are other data sources from different programmes, but they are fragmented and collected for other purposes. In terms of this paper, the most reliable sources are: the Living Standards Measurement Study, published by INSTAT (INSTAT, 2002, 2005, and 2008); the World Bank Labour Market Assessment (World Bank 2006); the International Monetary Fund (IMF 2008a) and the Bank of Albania's yearly reports (Bank of Albania 2008, 2009).

remained unchanged, while inflation stood at 3.1 per cent. In 2009–2010, the minimum wage increases also remained slightly below average wage increases.

TABLE 2.2 ANNUAL CHANGE IN MINIMUM AND AVERAGE REAL WAGES, ALBANIA, 1999–2010												
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Average wage, real	12.836	14.360	16.636	19.330	20.644	23.868	26.282	28.119	32.703	37.467	40.446	43.420
% increase		11.8	15.8	16.1	6.8	15.6	10.1	6.9	16.3	14.5	7.9	7.3
Minimum wage, real	6.444	6.718	7.324	9.243	9.739	10.568	11.568	13.658	13.579	16.626	17.334	18.354
Annual increase of minimum wage (real)		4.2	7.7	26.2	5.3	8.5	9.4	18	−0.5	22.4	4.2	5.8

Source: INSTAT 2011; author's own calculations.

2.4 | A low but constant wage share

The wage share in total budgetary expenditure has remained fairly constant, standing at 15.1 per cent in 2000 and around 17 per cent from 2001 to 2007 (with the exceptions of 2005 and 2008) (see Table 2.3). Furthermore, the wage share fell to less than 16 per cent in 2008 and 13 per cent in 2009 – while employment in the public sector stayed almost unchanged and public sector wages were increased every year (Ministry of Finance, 2009).

TABLE 2.3 WAGE SHARE, ALBANIA, 2000–2008 (MILLION LEKS)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total expenditure	170,621	186,049	192,517	201,152	222,439	232,339	258,816	285,674	354,760
Total wage fund	25,820	32,939	33,411	35,741	39,069	42,801	45,575	49,663	56,451
Wage share in %	15.1	17.7	17.4	17.8	17.6	18.4	17.6	17.4	15.9
FDI in leks	143,000	207,000	135,000	178,000	338,000	262,000	325,000	662,000	937,000

Source: Ministry of Finance, 2009; author's calculations.

3 | Major wage and income determinants

3.1 | Foreign direct investment: Contributing to high wage growth

Foreign direct investment (FDI) in Albania more than doubled between 2004 and 2008, and from 1995 to 2008 there was a thirteen-fold increase. However, wage increases have been tiny and almost indiscernible (see Table 2.4).

TABLE 2.4 | FOREIGN DIRECT INVESTMENT, ALBANIA, 1995–2010
(MILLION US DOLLARS (US\$))

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
FDI	70	90	48	45	41	143	207	135	178	338	262	325	662	937	925	1,109

Source: Bank of Albania, 2010.

While low labour costs may be attractive for FDI, the pressure to raise wages is increasing. But they have not been so low as to represent a particular enticement. In any case low wages for unskilled workers are of little interest to either foreign or domestic investors. It is also important to note from several sources that private sector salaries are systematically underreported and salaries in general are not as competitive as they might seem in terms of labour costs (World Bank, 2006b).

Comparative estimates assembled by the World Bank (2006b) indicate that Albania's net wage (in Euros, public sector only) was 73.5 per cent of the (unweighted) regional mean in 2004. This may reflect the relatively low levels of labour productivity that still characterize Albania. Almost 60 per cent of total employment is still in agriculture where production is small-scale and typically organized around household units. In 2004, the self-employed accounted for 61 per cent of employment, with three-quarters of this self-employment in agriculture. Wage earners represented just 38 per cent of all employment in 2004 (World Bank, 2006).

However, between 2000 and 2004, Albania's net wages grew by about 70 per cent, at a much higher pace than in the rest of the region – with a regional average of 48.5 per cent (World Bank, 2006b).

3.2 | Remittances: A significant complementary source of income

The large scale of the remittances from abroad has helped to cushion the effects of high unemployment and low wages in general. In Albania, this phenomenon has been studied as an issue in its own right because of its impact on the population and economic growth. In the short term, migration continues to have a positive effect as a result of the high level of remittances, which play a significant role in macroeconomic stability, investment (including within enterprises), the injection of know-how, maintenance of living standards and poverty alleviation.

In the period 1998–2002 remittances constituted 10 to 22 per cent of GDP, thus representing Albania's main source of foreign currency (UNDP, 2005). In 2005, remittances from abroad were estimated at 12–20 per cent of GDP (UNDP, 2006) while in 2007 they accounted for 12–13 per cent of GDP (Bank of Albania, 2008). The Bank of Albania reports that remittances decreased by 25 per cent in 2009. Having said that, as remittances are typically channelled outside the commercial banking system, it is difficult to accurately assess their size and impact (OECD, 2005). On the other hand, many people of working age throughout Albania, mostly in urban but also in rural areas, have withdrawn from the labour market because their remittance earnings are higher than any amount generated from formal employment. This applies in particular to women of working age whose husbands or sons work abroad. In the past, the presence of male household members working abroad significantly increased the female labour supply in the area

of self-employment, while reducing the supply of women available for unpaid care work and voluntary work.

3.3 | Widespread informal wage payments

Enterprises systematically underdeclare wage levels and so underpay social security contributions by officially declaring that their workers are receiving only the official minimum wage and paying additional sums informally, generally in cash. This is done largely in collusion with employees, who prefer direct cash payments to future social benefits. This behaviour is justified by employees and employers on the grounds that the current level of state pensions is too low and the national social and health insurance system remains in a poor state. According to the Department of Social Administration officially registered enterprises underreport their labour force by approximately 30 per cent (OECD, 2005). Furthermore, the risk of incurring fines due to social contribution evasion is so low as to be negligible. Typically, for example, enterprises are only given a first warning when an instance of evasion is discovered. Moreover, the ability of inspectors to detect evasion is severely limited when companies overuse wage payments at the minimum wage level (OECD, 2005).

3.4 | Social security contributions affecting final income

In Albania, the payment of social and health insurance premiums is mandatory and contributions are directly deducted from income together with other taxes. Social security contributions are calculated on the basis of the gross wage, with minimum and maximum limits. In fact, there are two minimum levels: 16,125 leks (the floor for self-employed persons and domestic workers), and 18,000 leks (all other employees) – while the maximum is 80,200 leks. In addition, people are entitled to benefits only if they have contributed. An estimated 30 per cent of employees in formally registered enterprises are not reported by the companies to the authorities and do not pay any social security contributions. Those who pay generally do so at the minimum wage level, thus contributing only minimally to social security and personal income tax.² Based on interviews, entrepreneurs behave in this manner primarily to remain competitive, since “everybody else does it”. Another reason is that employees lack confidence in the state’s capacity to provide for their future pension and health needs. In order to promote and boost the widening of the contribution base, the Government has since 2008 decided to apply two different levels for the minimum contribution base, as shown in Table 2.5.

² Personal income tax is paid on income generated by persons, businesses and properties. Before 2005 the income tax was progressive; since 2005 it has been replaced by a flat rate income tax of 10 per cent. Every employee pays 10 per cent out of the gross wage in personal income tax.

TABLE 2.5 | SOCIAL SECURITY CONTRIBUTION (SSC) RULES, ALBANIA, 2005–2010

Year	SSC total (percentage of gross nominal wage)	SSC employee (percentage of gross nominal wage)	SSC employer (percentage of gross nominal wage)	Contribution	Minimum	Maximum
				base definition	contribution base (in leks)	ontribution base (in leks) ³
2005	41.9	11.2	30.7	Nominal Wage	12,514	62,570
2006	32.9	11.2	21.7	Nominal wage	13,140	65,700
2009	24.5	9.5	15	Nominal wage	16,120 ⁴	80,600
2010	24.5	9.5	15	Nominal wage	16,820	84,100

Source: Law No. 7703, dated 11 June 1993; Law No. 9600, dated 20 July 2006; Law No. 10070, dated 05 February 2009; Council of Ministers Decree No. 385, dated 31 June 2005; Council of Ministers Decree No. 444, dated 21 June 2006; Council of Ministers decree No. 700, dated 18 June 2009; Council of Ministers Decree No. 477, dated 30 June 2010.

3.5 | Low labour force participation

Labour force participation and employment have lagged well behind population and production growth. Public sector employment has declined enormously during the transition period, but job growth in the private sector has been too slow to compensate. In fact, less than 20 per cent (17 per cent in 2007) of total employment is in the public sector. According to INSTAT (2009), private-sector employment increased by only 23,000 between 2001 and 2004, adding only 2.5 per cent of total employment over this period. As in other transition economies, labour was not a major factor for growth, partly because of high labour mobility to advanced economies and a big proportion of workers in the informal economy. The labour market in Albania is problematic and requires serious reforms in order to function properly. The Government has approved a strategy for employment in 2007–2013 to address the problems and offer medium-term solutions with its six year strategy.

The labour market in Albania continues to be dominated by male employment. In 2008, the female employment rate was 45.6 per cent, 17.4 percentage points lower than the male employment rate (see Table 2.6).

TABLE 2.6 | EMPLOYMENT, DISAGGREGATED BY SEX, ALBANIA, 1995–2008

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total employees ('000)	1,138	1,116	1,107	1,085	1,065	1,068	920	920	926	931	932	935	1,998	974	925
Male	684	676	684	676	661	641	578	577	579	578	576	578	671		
Female	454	440	423	409	404	427	342	343	347	353	356	357	527		
Male employment rate	63	60	59	57	56	55	52	52	61	50	47	46	63.6	63	64.3
Female employment rate	50	48	45	43	42	44	39	40	38	39	36	36	49.3	45.6	43.6

Note: for 2008 and 2009, INSTAT provides data only in percentage terms.

Sources: INSTAT; author's calculation of working age population and female employment rate.

³ This figure forms the basis for the calculation of social security and health insurance.

⁴ Two different minimum wages for social security calculation are provided. The lower one is usually used for the payment of voluntary contributions.

The Labour Force Survey of 2007 shows that unemployment remained high, with male unemployment at 14.4 per cent and female unemployment at 12.2 per cent. At first glance, it seems that women are at an advantage in the labour market, but needs to be taken into consideration that a large proportion of Albanian men are working abroad and many of the rest are “disinclined” to register as unemployed. This situation on the labour market obviously influences final wage and income outcomes.

3.6 | Informal economy: Due to a lack of jobs in the formal sector?

Data on individual employment and on non-farming family enterprises show that about 10 per cent of employees in Albania work as part of non-farming family enterprises or as self-employed. The informal economy in Albania is bigger in urban areas (24 per cent) than in rural areas (5 per cent), and higher in Tirana (about 15 per cent) (INSTAT, 2005). Almost three-quarters of those working in the informal economy are hired for at least three years and about 10 per cent of them have been working in the informal economy for more than 10 years. More than 90 per cent of those working in the informal economy entered it because they could not find a regular job (Ministry of Labour, Social Affairs and Equal Opportunities, 2007a). The results of an ILO survey in the Albanian construction sector (Balliu, 2008) help to identify some of the reasons for the informal economy. A significant number of employees in the construction sector indicated that the level of social and health contributions in Albania was too high. They reported preferring to receive their wages without deducting a portion of social and health contributions and personal income tax. Based on the survey's findings, informal employment thus seems to be widely accepted as “normal” in the labour market. Since May 2009 the social and health contribution tax for employees has been 11.2 per cent and the personal income tax 10 per cent. Altogether, the combined tax amounts to 22.2 per cent, which is deducted from the gross wage.

Furthermore, most of the surveyed people (72 per cent out of 200 persons) declared that they were purchasing items originating in the informal economy. Based on the survey's findings the sectors where informal labour was particularly widespread were trade (19 per cent), services (41 per cent) and construction (19 per cent). These sectors are also the main contributors to Albania's GDP growth (41 per cent of GDP growth in 2004; OECD, 2005).

3.7 | Agriculture still dominating the Albanian economy

The economy is still dominated by agriculture and other traditional activities. Agriculture still accounts for almost 60 per cent of total employment, while production is small-scale and, typically, organized around the household unit. Given this situation, it is not surprising that the “modern” wage sector is fairly small. In 2004, the self-employed accounted for 61 per cent of employment, three-quarters of which are in agriculture. The agricultural reforms carried out in the transition period and the resulting land redistribution led to a highly fragmented sector. Albania's land reform was unique among transition countries for its rapidity and intensity: by the mid-1990s, 94 per cent of farmland had been privatized (World Bank, 2004), with 550 state and collective farms split into 460,000 privately owned farms that averaged 1.1 hectares per farm (World Bank, 2004; MOAFCP, 2005). In Albania, decollectivization

(the return of property that had been collectivized during the socialist period) was faster than in any other transition economy in Central and Eastern Europe. However, in contrast to Albania's neighbours, redistribution was not based on restitution and therefore it benefited all rural households (Cungu and Swinnen, 1999). The labour market for agricultural work is very thin (Miluka, 2008), while formal rural credit and insurance markets remain virtually non-existent.

3.8 | The continuous growth of self-employment

Self-employment has tended to grow year-on-year even outside agriculture. Country-wide, 66 per cent of persons in employment are self-employed and only 34 per cent are hired. There are no data on the wages of self-employed people but those who file a tax return report the minimum wage. To improve the situation, the Government in 2006 issued a decree that obliges the self-employed and others working in the private sector to base their self-assessment on reference wages by occupation.⁵ This was done with a view to curbing tax evasion.

Of those in regular employment, 62 per cent work full-time and 38 per cent work part-time. A larger proportion of men (70 per cent) work full-time than women (51 per cent). People with a university education largely work full-time (75 per cent), as do those with a high school education (73 per cent), while less qualified persons lag behind in this respect (55 per cent). In 2006, the Government approved a plan to reduce the size of the informal economy (Decision no. 430, dated 28 June 2006). The progress and effectiveness of this plan are to be evaluated in the near future.

4 | Wage policy areas

4.1 | Existing legislation on wages

Wage legislation comprises the Constitution, the Labour Code and the Law on wage-setting competencies. On this basis, wages of public sector and local authority employees are set by decision of the Council of Ministers, while the wages of employees in independent institutions –such as the judicial system, the Ombudsman's Office and the National Council of Radio and TV– are decided by the Parliament. Wages in the public sector are fixed annually by the Council of Ministers' decree and based mainly on GDP growth and economic performance.

Albania has a statutory minimum wage that is set by the Council of Ministers and serves as the basis for collective bargaining. The social partners can determine wage levels primarily in the private sector through general and branch agreements, and that cannot be lower than the official minimum wage.

The legal basis for tripartite social dialogue was created in 1995 by the Labour Code of the Republic of Albania (Law no. 7961, dated 13 March 1996). In 1997, the National Labour Council (NLC) was launched

⁵ Reference wages refer to minimum level wages set for some professions (e.g. manager, accountant, high qualified specialist) within private companies and for self-employed persons – the latter as the minimum base to calculate the personal income tax.

as the highest national institution of tripartite social dialogue. The NLC has a tripartite structure with 27 members (seven government representatives, 10 representatives of employers' organizations and 10 representatives of employees' organizations). A number of specialized tripartite commissions support the NLC. The current system of social dialogue in Albania is facing various challenges in terms of its stability and efficiency and balance among the social actors. The NLC is an advisory body to the Ministry of Labour, Social Affairs and Equal Opportunities. In theory, it should have a say in setting wage levels, especially the minimum wage, but in reality it is very weak, to say the least.

4.2 | Weak industrial relations especially in the private sector

The European Commission's progress report of October 2009 also stated that (bilateral) social dialogue was still at a developing stage (EC, 2009).

In fact, effective collective bargaining remains difficult. There are individual contracts at company level but collective agreements are rare. The lack of employers' organizations particularly limits enterprise collective bargaining in the private sector. Collective agreements in Albania are thus found almost exclusively in the public sector, which in 2007 represented only about 17 per cent of the labour force (Ministry of Labour, Social Affairs and Equal Opportunities, 2009). And even in the public sector where unions are widespread and fairly strong, recent public sector wage increases have mainly been the result of government decisions rubberstamped by unions. In the past four years the highest wages increase were in the education sector where the strongest unions prevail and a tradition of organized labour exists. In the emerging private health and education sectors employees suffer from the same problems as all other private sector employees – namely that small businesses are predominant and trade union and collective bargaining coverage is minimal. Nonetheless in 2008, collective bargaining agreements were signed in construction where they had not existed in the past. Finally, labour relations in Albania are fairly well developed in urban areas, where the social partners are stronger and able to negotiate and reach agreements (Ministry of Labour, Social Affairs and Equal Opportunities, 2009).

No official data exist to allow a full assessment of industrial relations in Albania. For 2008, the Ministry of Labour, Social Affairs and Equal Opportunities reported that 372 collective agreements covered 175,183 employees in the public sector, while in the private sector 311 collective contracts covered only 24,750 employees. The latter is an indication that the rapid growth of the private sector has not been accompanied by the signing of new collective agreements. This is because the private sector in Albania has developed primarily in small and family businesses. In 2008, 54 per cent of businesses had no more than 20 employees, which dropped to 51 per cent in 2009 (Ministry of Labour, Social Affairs and Equal Opportunities, 2009). The predominance of small family businesses has weakened the clout of unions which find it easier to organize and represent larger enterprises.

4.3 | Wages influenced by reforms in the public sector

Before 1990, the wage system in Albania was entirely centralized, with 500,000 employees including members of agricultural cooperatives paid from the state budget. Each administrative unit, as well as each state enterprise, had its own wage system, but there were no essential differences in the payment levels because of the salary equality system introduced in 1969. Between 1991 and 2001, the public administration faced a massive decline in employment levels as a considerable number of employees transferred to the private sector. In 1991, a major legislative change was made with regard to working time: for the first time, a five day working week was introduced which led to a further increase in salaries. The year 1998 marked a qualified change in the management of public administration. The Law on the Status of Civil Servants was approved by the Parliament and paved the way for the creation of a professional, merit-based and impartial public administration. Its main objective was to create and improve standards of work and implement rules and regulations for the hiring and layoff of civil servants, as well as initiate processes to encourage citizens to become aware of their government and participate actively in public administration reform. The reform was aimed at making the system more efficient in terms of improving and enhancing the capacities of civil servants and motivating them to be creative in the modernization of the public administration (World Bank, 2006).

Initial coverage of the Law on the Status of Civil Servants was restricted to professional and managerial staff within central administration which represented less than 1 per cent of staff. This made it possible to increase civil servants' salaries, while not overdrawing the budget (Reid, 2005). Wage reform in the public administration began with a wage survey in the different sectors of the economy in 2000 (Institute of Contemporary Studies and Institute of Public and Legal Studies, 2002). Based on the findings of the survey the wages of public administration employees were reviewed and restructured to include the creation of a new civil servant pay scale. The main challenges of wage reform and the new pay scale in Albania were: (i) to create a unified system; (ii) to classify all civil servants at eight levels; and (iii) to create a flexible, but undistorted system. The new wage system provides a unified scale which makes it possible – by means of job evaluation – to fit any position. Exceptionally, the system also has a “market supplement” to cope with the recruitment and retention difficulties of the emerging Albanian labour market and its budgetary restraints.

The implementation of a new public wage system was carried out within the approved budget of 2001, although the wage increases for civil servants were substantial and in some job categories rose more than twofold. Besides this, public sector wage differentials were reduced although the total wage budget did not go up. The ratio between the public and the private sector was also drastically reduced.

The civil service wage reform increased the attractiveness of civil service positions (see Table 2.7). The total wage fund, as a percentage of GDP, was not increased. In the year 2000, that is, before the wage reform the overall budget-financed wage bill was 4.8 per cent of GDP, afterwards, in 2004 it went down slightly to 4.7 per cent.

Experts estimate that almost 20 per cent of wages in the private sector are lower than those in the public sector (Gajo et al., 2008). There are no official data to confirm this, but it is true that a large number of private sector employees receive or at least declare that they receive the minimum wage. This supposition is strengthened by the data provided by tax offices, which collect social and health

insurance contributions: most contributions are paid at the level of the official minimum wage. The minimum wage is increased annually and its rise has followed GDP growth and also takes inflation into account, except for 2000 and 2007 when the minimum wage increase was below inflation.

TABLE 2.7 | SELECTED WAGE INDICATORS, BEFORE AND AFTER WAGE REFORM, ALBANIA, 2000–2004

Indicators	Pre- or early reform	Post-wage reform
Average total wages of civil servants as a percentage of average private sector wages	53% (2000)	134% (2002)
Public/private competitiveness ratio	0.44 to 0.67 (2001)	1.04 to 1.91 (2002)
Ratio between the average salary of the most senior civil servants vis-à-vis the average salary of junior officials	6.3 (2000)	4.1 (2004)
Average number of qualified applicants per advertised position	5.9 (2003)	10.2 (2004)

Source: Reid, 2005.

4.4 | The central role of the minimum wage

The official minimum wage is set by decision of the Council of Ministers, as stipulated in the Labour Code. The minimum wage is decided at the national level and is compulsory for both public sector and private sector employees. Since 1999, the minimum wage has been raised several times, taking it from 6,380 leks in 1999 to 20,000 leks in 2011 (see Table 2.8).

TABLE 2.8 | OFFICIAL MINIMUM WAGE, ALBANIA, 1999–2011 (LEKS)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Minimum Wage	6,380	7,018	7,580	9,400	10,060	10,800	11,800	14,000	14,000	17,000	18,000	19,000	20,000
Percentage increase year-on-year	21	4	9	26	5	9	9	18	0	21.4	5.9	5.5	5.2
CPI	1	4.2	3.5	1.7	3.3	2.2	2.0	2.5	3.1	2.2	3.7	3.4	4.2

Sources: Council of Ministers Decree No. 203, dated 22 April 1999; Council of Ministers Decree No. 374, dated 14 July 2000; Council of Ministers Decree No. 423, dated 11 June 2001; Council of Ministers Decree No. 307, dated 27 June 2002; Council of Ministers Decree No. 588, dated 28 August 2003; Council of Ministers Decree No. 405, dated 25 June 2004; Council of Ministers Decree No. 460, dated 23 June 2005; Council of Ministers Decree No. 245, dated 27 April 2006; Council of Ministers Decree No. 235, dated 27 February 2008; Council of Ministers Decree No. 995, dated 2 July 2008; Council of Ministers Decree No. 522, dated 13 May 2009; Council of Ministers Decree No. 566, 14 July 2010; INSTAT 2010.

The official minimum wage represents the lowest level for wage setting in general or branch agreements between employers and employees. However, in many instances, the minimum level in these agreements is higher than the official minimum wage. The minimum public sector wage, published in the annual reports of the Ministry of Finance, serves as a benchmark for both the minimum wage and the minimum social security contributions base.

Despite the regular adjustment of the minimum wage the prevalence of poverty in Albania highlights the need for it to play a more active role to protect the most vulnerable workers.

4.5 | A renewed interest in non-monetary benefits

During the socialist era the role of fringe benefits was important and ideologically desirable as they complemented very low basic wages and also helped to compress wage inequalities. However, as part of efforts to decompress wages and, at the same time boost fiscal revenues and reduce social security contribution deficits, these benefits have either been abolished or scaled back (Gajo et al., 2008). The two most important fringe benefits inherited from the former system are untaxed cash allowances for the monthly hot meal allowance and the annual leave allowance. Hot meal allowances are sometimes given in the form of coupons, but they are generally convertible into cash. In Albania, no data are available on these non-taxable allowances, which continue to be provided mainly in mining and cement factories. It is important to mention that last year, during wage negotiations, employee representatives called for the restoration of some in-kind benefits (information from the Ministry of Labour, Social Affairs and Equal Opportunities, Department of Trade Union Relations, July 2009).

4.6 | Tax reforms: The need for a more progressive system?

A significant feature of the labour tax regime in Albania is the absence of deductions, credits and varying wage rates. As a consequence, the taxation of labour income is not progressive. Workers with dependent families face roughly the same tax wedge as single persons. Furthermore, tax wedges are generally constant across wage levels. In August 2007, a 10 per cent flat tax on personal income replaced the previous system of five income-dependent rates, set at 5, 10, 15, 25, and 30 per cent. Personal income tax was now to be 10 per cent of the gross wage, with a personal allowance of 10,000 leks (about 70 euros). Dividends received by individuals remained taxed at 10 per cent. The small-business tax rate was reduced from 30 per cent to 10 per cent (Iradian, 2007). The period during which the new tax system has been operating is too short to draw any conclusions about tax revenues.

Although wages have risen substantially, the introduction of a flat tax has had the effect of dampening their increase. Low-wage earners are more personally affected by this new tax. Information provided by the Ministry of Education (2009) shows that the application of the flat tax has widened wage differentials and shifted the tax burden to low wages. The introduction of a flat tax was intended, among other things, to combat the informal economy and increase employment. The reality has been somewhat different and confirms the opinion of some researchers that an almost exclusive focus on the efficiency of collecting labour taxes and contributions through the imposition of a high tax burden on low income labour has probably fed widespread informal employment and high unemployment (Gajo et al. 2008). Data from the Ministry of Education on university wages (for lecturers, assistants and other positions) show that the higher the wage level, the lower the tax burden. One illustration of this is the difference between progressive and flat rate taxation for university deans (monthly wage 142,375 leks). While with a progressive tax a dean must pay 14,296 leks/month, he or she pays 59 leks less with a flat tax at 14,237 leks/month. However, an assistant receiving a monthly wage of 65,575 leks (less than half the wage of deans) must pay 2,560 leks more under the new flat tax.

A relatively high tax burden with the minimum wage as a natural point of entry into the formal economy diminishes the incentive for workers to join the formal economy since they would have to

give up a significant portion of their informal earnings including the money generated from their unregistered employer's tax evasion efforts. Furthermore, measures to encourage formal enterprises serve as disincentives for potential investors who might wish to invest in labour-intensive sectors of the informal economy.

Other sources of information show that the new personal income tax is discouraging employees from paying taxes and from coming out of the informal economy. The main reasons why employers continue to operate in the informal economy and hire informal employees include labour shortages in the formal economy and its high level of social and health insurance contributions and of taxation (Balliu, 2008).

The personal income tax regime is de facto non-operational in the private sector since most private firms declare their employees only at the minimum wage, as already mentioned. As a result, personal income tax is creating tax discrimination between employees working in the private and the public sectors. To avoid this, in 2007 the Government issued a decree laying down reference levels for wages in the private sector. The idea was to increase personal income tax revenues (IMF, 2008b), but as Balliu (2008) testifies, the number of people preferring informal labour has ramped up because of the new requirement to apply the reference wages. In 2009, employee representatives demonstrated greater interest in negotiating non-monetary benefits, which indicates employees' increasing difficulties in coping with high personal income taxes, social security and health contributions and mounting prices for energy and consumer goods. In 2009, most collective agreements contained provisions for an agreement to non-monetary benefits (based on interviews with the Ministry of Labour, Social Affairs and Equal Opportunities).

4.7 | Poverty in Albania the highest in Europe: What role for wages?

Data on poverty provided by the Ministry of Labour, Social Affairs and Equal Opportunities show that Albania has one of the highest poverty rates in Europe. This continues to be a central policy concern (Ministry of Labour, Social Affairs and Equal Opportunities, 2007a). Poverty indicators in Albania are based on estimates of consumption rather than income, because information on income is reported less accurately. The absolute poverty line is defined in relation to a pre-determined basket of food and non-food items and allows easy comparison over time and across population groups.

The situation however somehow improved over the last decade. Absolute poverty, measured as real monthly per capita consumption below 4,891 leks in 2002 prices, fell from 25.4 per cent in 2002 to 12.5 per cent in 2008 (Ministry of Labour, Social Affairs and Equal Opportunities, 2009). Extreme absolute poverty, measured as real monthly per capita consumption below 3,047 leks in 2002 prices, includes those people who find it difficult to meet their most basic nutritional needs – a share of the population that dropped from 4.7 per cent to 3.5 per cent. In 2002, the poverty rate in mountainous areas was 49.5 per cent; in 2005 this indicator fell to 27.7 per cent. The same indicator in 2008 rose to 29.8 per cent (INSTAT, 2005 and 2006).

This poverty trend can be attributed, according to the data, partly to the fact that households have been receiving the highest average level of remittances. Poverty reduction might have been even faster

had it not been for the poor's inability to benefit proportionately from economic growth, particularly in the coastal and central areas. To select one of the standard measures of inequality, the share of total consumption enjoyed by the poorest 20 per cent of the population, fell from 12.7 per cent to 8.2 per cent between 2002 and 2005. The Government has set up a system of social protection to mitigate the impact of poverty. The main cash benefit programme is known as *"ndihma ekonomike"* (social assistance), which supports households with little or no earned income. Since 2000, however, *"ndihma ekonomike"* allocations have fallen from 0.8 per cent to 0.4 per cent of GDP. It should be noted that in Albania there is no official subsistence minimum. The poverty line has been set at two USD per day – in 2008, 12.4 per cent of the population lived under this level which is less than half than the 2002 level (25.4 per cent) (see Table 2.9).

TABLE 2.9 | ABSOLUTE POVERTY HEADCOUNT RATE, ALBANIA, 2002–2008

Zones	Poverty measurement	2002			2005			2008		
		Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Coast	%	20.2	20.9	20.6	11.6	19.7	16.2	10.7	15.0	13.0
Centre	%	19.3	28.5	25.6	12.5	25.9	21.2	10.3	10.9	10.7
Mountains	%	24.7	49.5	44.5	17.1	27.7	25.6	14.7	29.8	26.6
Tirana	%	17.8		17.8	8.1		8.1	8.7		8.7
Total	%	19.5	29.6	25.4	11.2	24.2	18.5	10.1	14.6	12.4

Source: INSTAT, 2002, 2005, 2008.

The subject of poverty level and minimum living conditions as the basis for calculating the minimum income and/or wage increases is raised in almost all tripartite debates in Albania. Union representatives during the transition period have called for the official calculation and publication of minimum living standards in Albania which would assist them in their negotiations with the government in the drafting of policies for improving the living conditions of Albanians.

4.8 | Gender pay gap: Increasing along with women's falling participation

Data on poverty testify to the feminization of poverty (women comprise 51 per cent of the Albanian population). There are no reported indicators of gender gaps in school enrolment and attendance rates, but evidence shows that price liberalization and competition for scarce resources increased unemployment during the first years of the transition and women were affected more than men (World Bank, 2002). During the socialist period, women in Albania had a higher labour force participation rate due to government policies such as relatively high minimum wages, generous maternity leave and day-care benefits. In addition, considering the relatively low average wages, women were encouraged to work to supplement their family income (Grown and Miluka et al. 2007). During the 1990s women's labour market participation fell by nearly half, from 78 per cent in 1989 to 46 per cent in 2005. Women do not have the same opportunities as men in the labour market. Only 18 per cent of women are in positions of authority in the public administration (UNICEF, 2007).

Women also have a higher unemployment rate. The INSTAT data on the employment of females between 15 and 64 years show that only 14 per cent of women without work are involved in job seeking, while 86 per cent remain inactive. Many factors contribute to this state of affairs, including lack of child care facilities, scarce resources and the tight labour market.

Encouraging greater equality in the labour market in Albania would give women more control over their personal and social lives, and enhance their participation in the labour market and their influence over decision-making (Miluka, 2008).

4.9 | ILO identifying areas for improvement

After a break of 24 years, in 1991 Albania rejoined the ILO, and since then ratified a number of ILO conventions and committed itself to implementing them. The ILO supervisory system commented on a number of issues since Albania rejoined the ILO.

One observation by ILO (ILO, 2007) concerns Article 3 of the Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87) which was ratified by Albania in June 1957. The subject in question is the status of civil servants in Albania. As stated in the Law on the Status of Civil Servants (Article 20/d) all civil servants have the right to organize and be organized in trade unions, and to participate through unions or their representatives in decisions regarding their working conditions and terms of employment. There is no law on the exercising of trade union rights in the civil service in Albania. Article 19/f of the Law on the Status of Civil Servants prohibits strikes by civil servants, which the Government has sought to justify with reference to the importance of the public administration in the daily life of the population and the potential politicization of public administration activities. To date, no attempt has been made to amend the law.

Furthermore, the ILO's Committee of Experts (ILO, 2007) deals with the right to strike for reasons of solidarity. Accordingly, the Ministry of Labour, Social Affairs and Equal Opportunities has initiated a number of amendments to the Labour Code, and notably of Article 197/7 to include the right to engage in solidarity strikes, in support of legal strikes by other workers.

Point three of the ILO observations (ILO, 2007) concerns Articles 170-1 and 173-1.3 of the Albanian Constitution. A state of emergency may be declared in part or the whole of the country in situations in which the constitutional order and public security are at risk. The National Assembly has the sole authority for the declaration of such a situation. The duration of such a state of emergency may be no more than 60 days but this timeframe may be prolonged by 30 days with the approval of the National Assembly. Under Articles 170-1 and 173-1.3 of the Albanian Constitution, strike action is not permitted or, if already commenced, must be halted, for the period of the abovementioned state of emergency. There have so far been no judicial decisions in Albania dealing with such extreme circumstances.

Comments have also been made on the subject of remuneration. The Albanian Government's report on the Equal Remuneration Convention, 1951 (No. 100) presents a situation in which the relevant legislation is in place, but in which equal remuneration for equal work for men and women is far from being a reality (Ministry of Labour, Social Affairs and Equal Opportunities, 2009). In 2007, INSTAT, supported by UNICEF, undertook a survey on the situation of women and children in Albania. The results of this survey, among others, reveal inequalities in pay between men and women with the same level of qualifications

with also clear cases of discrimination against women in general (as reported in Section 3.8 above). It is important to note that the Albanian Government has taken very seriously the implementation of equal remuneration by establishing a National Council on Gender Equality (Prime Ministers Order No. 3, dated 8 January 2009) as an advisory body for the definition, direction and development of Government policies on gender equality.

Following developments in Albania with regard to Convention No. 87 and the Right to Organise and Collective Bargaining Convention, 1949 (No. 98), it would be important to have more detailed information on the problems facing unions in Albania today. Information provided by the Ministry indicates the weakness of trade union representatives, as well as the declining role of unions themselves. Since 2004, no General Agreement has been signed between the Albanian Government and the trade unions.

The weak role of trade unions in Albania can be explained by trade union fragmentation and insufficient support to their own members. Furthermore, existing trade unions have shown little interest in collaborating with the private sector to organize new bargaining units or adhere to existing branch unions in their particular sector.

As presented in the Albanian Government's report, workers in Albania are generally aware of the existence of Convention No. 98 and its provisions. Also unions have requested the enforcement of the law to protect their rights. Although Albanian legislation seems to be complete, its implementation must be improved with regard to Convention No. 98. The Ministry also needs to gather more data to facilitate overall and long-term assessments. A consolidated database of all employer–employee agreements, dismissals and other conflicts at work will enable state representatives to mediate and find rapid solutions before situations get out of hand and an unnecessary strain on resources occurs. It is also worth mentioning that the social partners have not conducted their own studies of or made complaints related to inequality at work.

5 | Impact of the global economic crisis on Albania: First signs late 2008

In 2008, there were no significant indications of any direct or indirect threat to the financial system as a result of the international financial crisis, given the low international exposure of Albanian banks. Growth in 2008 was more than 6 per cent. Despite this sound economic framework, the impact of the global crisis started to be visible during the last quarter of 2008, and even more in early 2009. Based on official statistical data, as of January 2009 exports had decreased by 11 per cent compared to January 2008. The crisis was also becoming evident in construction which has experienced a decrease in turnover. In 2010 the volume of turnover in comparison with the fourth quarter of 2009 decreased by 4.3 per cent (INSTAT, 2010).

The sectors most affected by the crisis, especially in 2009, were in industry, and especially buyers of imported raw materials for shoes and clothing. If we compare 2009 with 2008 the highest growth increase in terms of volume could be observed in the services sector (+5.3 per cent), while the agriculture sector, after increasing by 7.3 per cent in 2008, rose by +3.3 per cent in 2009. In 2009, services generated 58 per cent of GDP compared to 23 per cent for industry and 19 per cent for agriculture (INSTAT, 2009).

Industry, however, started to recover quickly in 2010 alongside foreign businesses' growing demand for goods produced in Albania.

The decrease in the quantity of remittances from abroad (remittances from migrants total 1 billion euros per year) was another sign of the impact of the crisis on the Albanian economy. The impact of the crisis on many European countries, especially Italy and Greece, has had an adverse effect on this important source of revenue for Albanians. The Bank of Albania warned the Albanian government about the decrease in remittances following the effects of the global crises on neighbouring countries, where most Albanian emigrants reside. The poor economic outlook is deepening the financial difficulties of entrepreneurs and households, and the Bank of Albania has warned the Government that "the business difficulties will have a negative impact on employment, adversely affecting the incomes of individuals and households" (Bank of Albania, 2008).

Clearly, ordinary Albanians, specialized institutions and independent experts alike started to be worried about their country's economic situation and urged the Government to do something about it. The Albanian Government began to take measures in 2009, including administrative and operational expenditure cuts. Despite wage increases in 2008 and 2009, the wage share as part of budgetary spending declined to 16 and 13 per cent, respectively, in those years compared to 17.1 per cent in 2007. It seems that the reason for the decrease was mainly the reduction in the number of public employees.

With regard to wages, constraints were imposed by the IMF as part of the Three-Year Arrangement under the Poverty Reduction and Growth Facility which warned the Albanian Government about wage increases: "To improve targeting of scarce resources, it was also agreed to reallocate budget provisions that were previously earmarked for wage increases to a targeted social safety net to compensate for higher food and energy prices" (IMF, 2008b). In other words, the IMF requested a wage freeze in 2009. However, 2009 was an election year so that the Government could not resist increasing both wages and pensions. The IMF also advised the Albanian Government to further tighten wage increases to prevent price increases: "In the face of an unfavourable global inflation outlook, the monetary authorities need to stand ready to tighten again. Global and transition forces imply upward pressures on prices in the short and medium term. Moreover, now is not the time to implement large wage increases and risk launching a potential wage-price inflation feedback loop" (IMF 2008b).

However, IMF predictions of zero GDP growth in 2009 were not realized. In fact, GDP rose by 3 per cent and official data for the first three months of 2010 show that the Albanian economy is recovering quickly. The Minister of Finance announced an increase in Albanian exports of 24 per cent in April 2010. The Government has also announced increases in wages, pensions and social assistance, despite IMF warnings of another difficult year. The data for the 2010 vindicate this policy.

6 | Conclusions and policy issues

In such a context, and considering both wage trends but also major wage policy tripartite conclusions recently adopted in November 2011 (see Annex), the following policy recommendations are proposed:

1. Establishment of sustainable tripartite relations with the social partners and an open and transparent dialogue on important issues. The social partners should become active participants in social dialogue for setting minimum wages and drafting policies and programmes with government representatives to improve working conditions and reduce poverty.
2. Better cooperation between government and social partners to increase transparency and raise public awareness of the risks of informal labour.
3. Improvement of legislation to further reduce informal labour by respecting and implementing labour contracts in close cooperation with employees' representatives and professional associations.
4. Assessment and revision of the legal system to reflect the requirements of international conventions that have been ratified by Albania.
5. Improvement of the functioning of consultative councils and an increase in the efficiency of social dialogue at central, branch, regional and local levels.
6. Improvement of the organization and functioning of National Labour Council and its wage committee.
7. Establishment of a centralised database on general and branch agreements.
8. Establishment and implementation of an overall wage database for both the public and private sector.
9. The Ministry of Labour, Social Affairs and Equal Opportunities should regularly collect and publish detailed information on the labour market, wages, pensions and social assistance.
10. A subsistence minimum should be officially calculated as the lowest level for drafting and implementing poverty reduction programmes.
11. Implementation of recently approved business legislation, including measures to alleviate the situation of businesses at risk – they are particularly vulnerable to the crisis – by introducing measures such as loan restructuring and tax breaks.
12. Reduce the fiscal wedge on consumption by introducing progressive taxation of lower income groups.
13. Implementation of a recently approved system of tax returns, based on an annual baseline of personal or family expenditure.
14. Preparation and implementation of a minimum wage policy aimed at protecting the most vulnerable workers, while also promoting and motivating skilled labour.
15. Until a comprehensive reform of wage taxation is introduced, it will be worth preserving (in the short term) some non-taxable fringe benefits such as the still existing “hot meal allowances.” This can maintain progressive aspects in the sense that these allowances lower the tax wedge, especially for low-income workers. In the longer run, however, non-taxable fringe benefits should be eliminated.
16. Introduction of an effective voluntary third pillar (private pension funds) in the pension system.
17. Besides the consumer price index, detailed calculations should be made and published by official institutions on food basket prices, a minimum standard of living index and a pension basket. The calculation of such indexes is sanctioned in various laws and regulations, but so far not realized in practice.

18. In November 2011 a National Labour Conference on Wage Trends and the Wage Gap was jointly organized by the ministry of Labour, Social Affairs and Equal Opportunities and the ILO. The two days' conference provided an opportunity to hold detailed discussions on the issues highlighted in this paper, such as the relationship between the minimum wage and the subsistence minimum; low wage levels in general and poverty reduction; wage disparity that affects certain groups of workers as a whole, but in particular women workers; a disconnect between wages and productivity and a general wage-fixing process that does not seem to sufficiently involve workers' and employers' representatives. The conference also emphasized the need to improve both the legal and institutional wage policy framework in the country. The importance of having accurate, relevant and independent data on wages was also stressed. A national strategy on wages and income, which takes all the above into consideration, would be a concrete step forward in ensuring a better regulated wage and income increase in Albania.

Only with the above reforms could the wages and incomes of Albanians progressively increase to reach European standards, and wage policy start to play a more effective role in both alleviating poverty and modernizing the Albanian economy.

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Annex

National Labour Conference on Wage Trends and the Wage Gap in Albania

Tirana, 17-18 November 2011

Conference Conclusions

1. The National Labour Conference on 'Wage trends and the wage gap in Albania' was jointly organized by the ILO and the Ministry of Labour, Social Affairs and Equal Opportunities in Tirana, 17-18 November 2011. It responded to the request made by the Albanian authorities for continued technical assistance on wage issues. Representatives from the Government, employers' and workers' organizations and national and International experts attended the conference, and actively deliberated on the global and Albanian wage trends and possible wage policy reforms.
2. The Conference provided a comprehensive overview of the situation of wages in Albania within the current national and international context, and shed light on the existing wage fixing mechanisms prevalent in Albania on the basis of reports by national experts. National experts reports identified sources of weaknesses in wage fixing mechanisms and emphasized the need for the government, in consultations with social partners, to undertake fundamental wage policy reforms.
3. The two days' conference shed light on some of the "missing links" and challenges in policies influencing wage levels, such as the relationship between the minimum wage and the subsistence minimum; low wage levels in general and poverty reduction; wage disparity that affects certain groups of workers as a whole, in particular women workers; a disconnect between wages and productivity and a general wage-fixing process that does not seem to sufficiently involve workers' and employers' representatives. The conference also emphasized the need to improve both the legal and institutional wage policy framework in the country. The importance of having accurate, relevant and independent data on wages was also stressed.

Identified priorities

The participants agreed on the following priorities:

4. The need to establish clearly defined wage-fixing process at different levels: national, sectoral, and enterprise. Legal acts and provisions should better define the institutions in charge of wage-fixing in Albania.
5. The need to define/establish the responsibility on wage policy of the Ministry of Labour, Social Affairs and Equal Opportunities in cooperation with employers' and workers' representative within the existing National Labour Council and the Tripartite Wage Committee in the context of existing laws and provisions. The participants expressed their appreciation of the work done by the three sides within the tripartite wage committee, and insisted on strengthening its role, and widening the

scope of this committee beyond minimum wage issues to cover issues such as informal labour and payments, tax policy, and social security contributions.

6. Institutional capacity for the development and implementation of wage policies should be further strengthened in line with the respective responsibilities identified in paragraph five. Successful implementation of wage policies could be supported by awareness-raising of both employers' and workers' organizations, training and information dissemination about existing legislation, as well as strengthening the system of labour inspection on wage matters.
7. In particular, the role of the tripartite partners in minimum wage fixing should be more clearly defined and implemented through the existing tripartite institutions. The participants agreed that there is a need to improve the role of the minimum wage in line with the principle enshrined in C131 Minimum Wage Fixing Convention, 1970 (ratified by Albania in 2004) as a wage floor to protect the most vulnerable workers, especially within the context of the economic crisis. This should lead to a more regular adjustment of the minimum wage to take account of changing social and economic circumstances such as price increases, evolving living standards, and economic growth and productivity. At the same time a number of constraints that currently put unnecessary pressure on the minimum wage should be removed, by consultation and negotiation with social partners, so that the minimum wage can effectively play its social and economic role. Examples could be to remove the automatic link between the minimum wage and social benefits. Such reforms would also give more room for collective bargaining.
8. At the same time, bipartite wage negotiations between employers' and workers' representatives should be promoted to allow wage bargaining to develop as a major wage-fixing process at different levels – enterprise, sectoral, etc.
9. The above functions and mechanisms require a better and more regular collection, analysis and dissemination of wage statistics. An independent and reliable source of wage data is essential for tripartite discussions/negotiations and should also be complemented by independent studies on specific issues. In particular the need to start providing reliable data on the private sector was identified by all participants. Responsibilities for such data collection, analysis and dissemination process should also be more clearly designed within the National Statistical Institute but also within the Ministry of Labour (for instance on the registration and monitoring of the number and contents of collective agreements etc.) and other relevant Institutes (such as the Social Security Institute). Such data collection is essential for developing an effective tripartite forum on wage policies in Albania and allow its actors to better monitor wage trends and accordingly discuss and negotiate the necessary wage developments in the country.
10. The persistence of a significant gender pay gap also requires specific initiatives to improve the situation. All wage policies and other policies (education, health, childcare, social protection) should also be aimed at reducing the gender wage gap. More flexibility to improve both wages and employment conditions of women should also be envisaged and discussed continuously between employers' and workers' organizations and be supported by public authorities' initiatives.
11. The participants also highlighted that wage policies should generally figure more prominently on the policy making agenda considering its multiple effects on both workers and employers. At the same time, wages are only one part of an integrated, comprehensive policy framework which should

also include non-wage areas such as taxation, social security contributions, etc. The need for a government strategy on wages and incomes was emphasized.

12. This should aim at ensuring the respect of current national and International standards ratified by Albania on such major issues as the obligation to protect wages, make progress towards the realisation of equal pay for work of equal value, enable the minimum wage to play its social and economic functions, promote wage bargaining and social dialogue on wages, and generally ensure a more equal and effective wage-fixing process in the country.
13. The participants welcomed the timeliness of this National Labour Conference. They requested the ILO to continue to provide policy advice and technical assistance on wage policies.

The Impact of the Crisis on Wages in selected Balkan Countries

3 Bosnia and Herzegovina: Wage trends and policies in response to the financial and economic crisis¹

NIAL O'HIGGINS

1 | Introduction

The general macroeconomic environment, like many aspects of life in Bosnia and Herzegovina is still feeling the effects of the 1992–95 war. Although not comparable to the huge growth rates fuelled by massive international aid in the period immediately following the conflict, real economic growth has remained strong and stable since the beginning of the new millennium until the global financial crisis started to make itself felt in 2009. Real GDP growth averaged around six per cent per year during the period 2003–08, while GDP per capita seemed to be increasing until the economic downturn came

¹ Thanks are due to Lejla Tanovic, ILO National Coordinator in Bosnia and Herzegovina, without whose extensive work in providing information and data, this chapter would not have been possible. I hasten to add that neither she nor the ILO are responsible for the views expressed in this chapter, nor indeed for any errors which may remain.

along. However, a comparison over time is problematic, given the lack of agreement on the size of the population in Bosnia and Herzegovina.²

Inflation has also, for the most part, remained low since 2000, although it showed some signs of rising in 2005 that was temporarily exacerbated by the introduction of VAT in 2006. Government expenditure as a percentage of GDP is relatively high in comparison to other countries in South-East Europe; but it has fallen significantly since 2000.³ Since 2003, the budget has sometimes even been in surplus. Furthermore, sustained growth, along with positive Government finances reduced the external debt from nearly two-fifths of GDP in 2000 to under one-fifth of GDP in 2007 and 2008 although it has now begun to increase again as the effects of the global crisis hit home.

External imbalances remain a serious problem. The negative balance of payments is largely the result of an extremely negative trade balance. Trade liberalization along with an exchange rate pegged to the euro (€) has meant a rapid increase in imports – mainly consumption goods – while exports have largely consisted of low value added products, such as raw materials, agricultural products and energy. This remains perhaps the most serious macroeconomic challenge facing Bosnia and Herzegovina. Yet, here too, significant improvements in the situation have occurred, with the negative trade balance dropping from more than 50 per cent of GDP in 2000 and 2001 to well below 40 per cent of GDP in 2006 where it has stayed. In 2006, export growth of 29 per cent contributed, along with productivity gains and export price increases, to pushing real GDP growth to more than six per cent, although export growth slowed down in 2007. Progress on the current account deficit, which more than halved as a percentage of GDP between 2005 and 2006, continued to worsen in 2007 and 2008, but recovered once again as the recession led to a significant drop in imports (see table 3.1).

2 There has been no population census since 1991. Understandably, the war and its aftermath caused fairly massive population movements and created problems in the absence of a census, for the gathering of population-related figures (for example, GDP per capita). Various population estimates are in use; for example, the official estimate for 2006 was 3,843,000 persons. The State Statistical Agency used an estimate of 3,372,000 for the 2006 Labour Force Survey; while the US Census Bureau estimate is 4,461,000. There is also disagreement over whether and/or when the GDP per capita level overtook its pre-war level. The European Training Foundation (European Training Foundation, 2007) reports GDP per capita as €1,600 in 2003 or “half the pre-war levels”; while the Report on State Employment Policies (Labour and Employment Agency for Bosnia and Herzegovina, 2007) reports the overtaking of pre-war GDP per capita levels (US\$2,000 in 1990) by 2004. In this case, the apparent discrepancy is explained largely by the use of a different base currency.

3 Although here again there is some disagreement over numbers. The table reports the Central Bank’s figures, while the IMF estimates reported by the Economic Policy Research Unit (EPRU, 2007) suggest that the reduction in government expenditure is much more modest.

TABLE 3.1 | MAIN ECONOMIC INDICATORS, BOSNIA AND HERZEGOVINA, 2000–2010

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Nominal GDP (million Bosnia and Herzegovina convertible mark (KM)) ¹	12,094	13,070	13,790	14,505	15,786	17,127	19,252	21,760	24,702	23,994	24,235
Nominal GDP per capita (KM) ¹	3,018	3,115	3,244	3,332	3,514	3,624	3,847	4,086	4,324	4,198	4,226
Real GDP growth rate ¹	5.2	3.6	5.0	3.5	6.3	3.9	6.1	6.1	5.7	-3.1	0.5
Industrial Production (% growth rate) ³				3.0	13.6	11.1	10.5	6.6	7.3	-3.3	
Gross investment (% of GDP) ²				20.4	19.4	27.4	20.9	24.9	24.8	19.1	21.3
Inflation rate (CPI) ¹	4.9	4.6	0.3	0.5	0.3	3.6	6.1	1.5	7.4	-0.4	2.4
Budget surplus/deficit (% GDP) ¹	-7.7	-4.2	-3.0	-1.7	-0.5	0.6	1.1	-0.3	-3.9	-5.8	-5.0
External debt (% GDP) ^{3,2}	37.9	38.1	31.1	27.7	25.6	25.7	21.3	18.3	17.2	21.5	26.3
Government expenditure (% GDP) ¹	58.1	49.6	48.1	48.6	46.5	45.9	46.1	47.1	49.8	50.4	50.9
Current account balance (% GDP) ¹	-7.0	-12.5	-17.8	-19.4	-16.4	-17.2	-8.0	-10.7	-14.5	-6.9	-5.5
Trade balance ³	-54.8	-55.8	-49.9	-49.5	-45.6	-45.8	-34.8	-37.4	-37.6	-27.8	
FDI (% GDP) ¹			4.3	4.9	7.1	5.5	5.8	13.3	5.7	2.1	3.9

Notes: * estimate/projection.

Sources: 1. IMF (2010a).

2. IMF (2007a, 2009, 2010b).

3. Central Bank of Bosnia and Herzegovina (2007, 2009, 2010).

The Dayton Peace Agreement (DPA) that was signed in December 1995 effectively ended the 1992–95 war and established the political framework for Bosnia and Herzegovina's development. The agreement created a complex, multi-layered and decentralized governance structure based around two largely autonomous Entities: the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS). In addition, the internationally-supervised District of Brčko (DB) was created on 5 March 1999 following an arbitration process undertaken by the High Representative for the Bosnia and Herzegovina State. The FBiH is further divided into ten cantons and 79 municipalities. The RS is less decentralized, has no cantons but it contains 62 municipalities. The DPA established the position of the High Representative – since February 2002 also the European Union's Special Representative – who is supported by the Office of the High Representative (OHR) to oversee the implementation of civilian aspects of the Peace Agreement. Over time, the role of the OHR has been gradually transferred to State-level institutions, as the first possible step towards its eventual closure.⁴ The principal State-level governing institution is the Council of Ministers but the responsibility for coordinating matters pertaining to employment and the labour market falls to the State-level Ministry of Civil Affairs. Decision-making powers on labour market matters are retained by the relevant Entity-level institutions.

Data for this report came principally from two sources: the annual Labour Force Survey, undertaken in April each year and carried out since 2006, and the monthly Enterprise Survey, which is common to all the former Yugoslav Republics. Arandarenko and Vukojevic (2008) argue that the Enterprise Survey has become less representative over time, due to deteriorating coverage and response rates as the regional

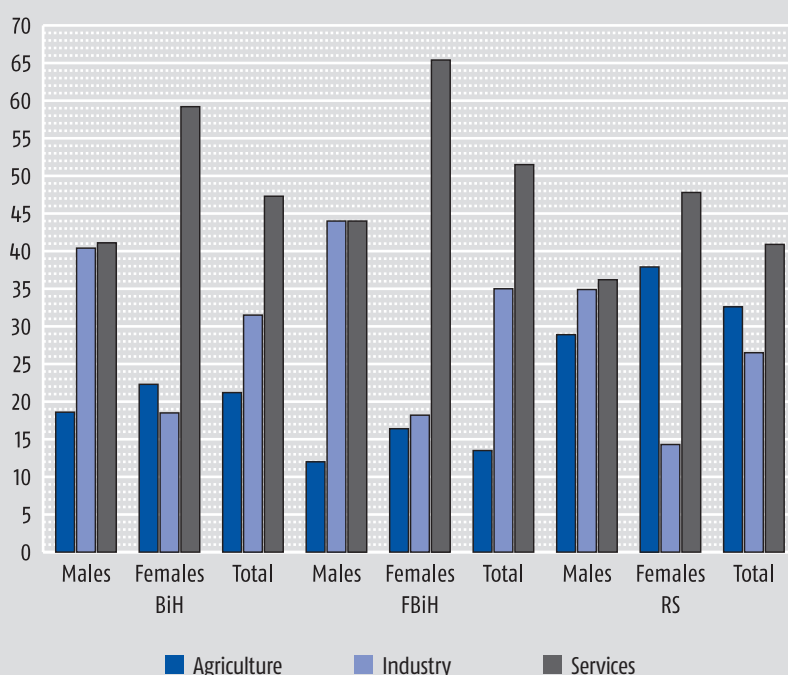
economies restructure, particularly in Serbia and Bosnia and Herzegovina. For obvious reasons, the survey covers only formal employment and over represents larger firms – to the detriment of the informal economy and small and medium sized enterprises which have become more prevalent in Bosnia and Herzegovina. As a consequence, there is a bias towards higher wage estimates in the results. However, the Enterprise Survey does provide a consistent and comparable series on wages. In this regard, it might also be added that, due to the differences in the definition of gross wages in the two Entities, net wage information provides a more comparable indicator of wage changes between them.

TABLE 3.2 | EMPLOYMENT RATES IN BOSNIA AND HERZEGOVINA AND NEIGHBOURING COUNTRIES, 2008

	Males	Females	Total
Bosnia and Herzegovina	44.9	23.1	33.6
– FBiH	43.3	21.1	31.8
– RS	48.0	27.2	37.3
– DB	34.9	15.6	25.1
Bulgaria	68.5	59.5	64.0
Croatia	65.0	50.7	57.8
Macedonia	50.7	32.9	41.9
Romania	65.7	52.5	59.0
EU-15	74.2	60.4	67.3
EU-27	72.8	59.1	65.7

Source: Data for Bosnia and Herzegovina comes from the Agency for Statistics of Bosnia and Herzegovina (2010), and for other countries, from Eurostat, available at: <http://epp.eurostat.ec.europa.eu/>.

Before considering wage developments, it is worth looking briefly at the larger employment picture in recent years. Employment rates in Bosnia and Herzegovina are extremely low in comparison to neighbouring countries (Table 3.2) and there is a huge disparity between the employment rates of men and women. With regards to sectoral employment, agriculture comprises around 20 per cent of all jobs and is concentrated in RS (Figure 3.1). There is also a heavy concentration of employment in services, particularly involving women above-all in the Federation of Bosnia and Herzegovina (FBiH).

FIGURE 3.1 | SECTORAL EMPLOYMENT AS A PERCENTAGE OF TOTAL EMPLOYMENT, BOSNIA AND HERZEGOVINA, 2009

Source: LFS data; Agency for Statistics of Bosnia and Herzegovina (2010).

Much like its neighbouring countries, part-time employment is not widespread in Bosnia and Herzegovina where it only accounts for 10.2 per cent of all employment in 2009 according to the Labour Force Survey. This type of job is principally concentrated in agriculture, among women, and in the FBiH where 61.2 per cent of employed women work in agriculture on a part-time basis (Agency for Statistics of Bosnia and Herzegovina, 2010). Given legislative restrictions on part-time employment contracts, part-time work is also largely concentrated in the informal economy in Bosnia and Herzegovina. The 2006 LFS reported that, overall only 2.0 per cent of men and 2.9 per cent of women working in the formal economy in the country have part-time contracts, while in the informal economy, part-time employment accounts for 27.9 per cent of male workers and 33.0 per cent of female workers. In the FBiH, 95.6 per cent of women working in agriculture do so on an informal basis and 58.6 per cent of women employed in agriculture are working informally on a part-time basis; none of the 4.4 per cent of women who work with a regular employment contract in agriculture in the Federation are part-time.

Although information is not routinely reported in the publications of the State Statistical Agency, the analysis of data from the Labour Force Survey suggests that informal employment comprises around one-

third of employment overall.⁵ A comparison of this with the figures derived from the Living Standards Measurement Survey (LSMS) 2001–04 (Table 3.3) suggests that informal employment has fallen somewhat. However, given the different sample base and size across the two surveys, some caution is in order in making firm pronouncements on this issue. Considering the earlier period, Dell’Anno and Piirisild (2004), estimate that informal employment, expressed as a percentage of formal as opposed to all employment, amounted to around 51 per cent, or, in other words, around one-third of all employment, as with the Labour Force Survey estimates. The absence of published statistics or more recent micro-data undermines the analysis of recent trends of this phenomenon.

TABLE 3.3 | INFORMAL EMPLOYMENT AS A PERCENTAGE OF ALL EMPLOYMENT, BOSNIA AND HERZEGOVINA, 2001–2006

	LFS 2006	LSMS 2001	LSMS 2004
Bosnia and Herzegovina	33.6	36.5	41.3
– FBiH	28.3	32.8	36.3
– RS	42.4	40.9	48.8
– DB	33.2	–	–

Note: Informal employment is defined as the percentage of those working whose (principal) employment does not include either health or pension coverage.

Source: Author’s calculations from Labour Force Survey 2006 and World Bank (2005).

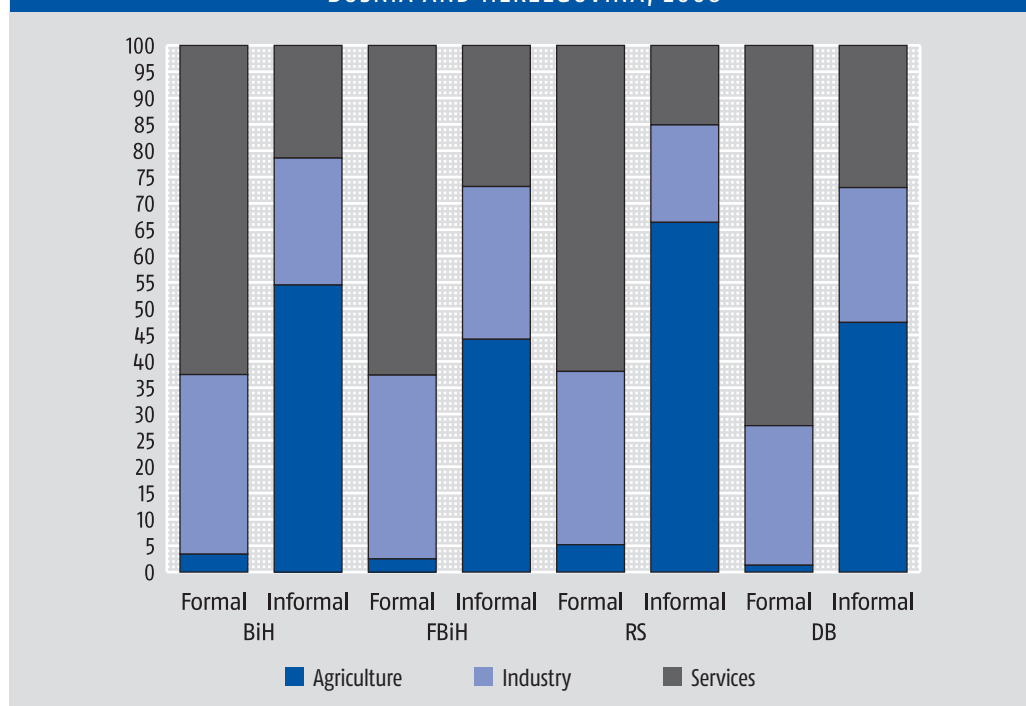
Figure 3.2 looks at the sectoral division of formal and informal employment on the basis of the 2006 Labour Force Survey data. The heavy concentration of informal employment in agriculture is evident from the figure, as is the relative concentration of informal employment in manufacturing as opposed to services.

Table 3.4 reports the incidence of informal employment by age for the different Entities, subdivided by gender in 2006. It will be observed that young people are disproportionately represented in the informal economy, particularly in the Federation of Bosnia and Herzegovina (FBiH). Also noticeable is the slight preponderance of males, particularly in RS. At first glance, the greater relative concentration of young people in the informal economy in the FBiH might be thought to reflect the higher minimum wage in that Entity at the time of the survey. Specifically, the incidence of informal employment is roughly twice as high for young people (15–24) as it is for prime age adults (25–49) in the FBiH, whereas the corresponding relative incidence in RS is of the order of 1.4. It might be thought that this could arise from a greater tendency of employers to avoid paying the higher minimum wage to young people in the FBiH. Upon closer inspection the available data suggests that this is not the case. Overall, the incidence of informal employment is much higher in RS than in the FBiH. If minimum wages were playing such an important role one would expect the reverse. Secondly, an examination of reported wages (LFS 2006 data) demonstrates that the wages of both informal and formal economy youth (ages 15–24) are roughly 73 per cent of adult (25–49) wages in both the FBiH and RS. Moreover, in the formal economy alone,

⁵ As with previous World Bank estimates, those who work but do not enjoy health and/or pension rights at work are defined as being in informal employment.

youth wages as a percentage of adult wages are roughly the same in the two Entities, while in the informal economy in the FBiH youth wages are much closer to adult wages than they are in either the formal economy in the FBiH or the informal economy in RS. Again, if the avoidance of minimum wages were playing a decisive role here, one would expect precisely the opposite.⁶

FIGURE 3.2 | FORMAL AND INFORMAL EMPLOYMENT BY INDUSTRIAL SECTOR, BOSNIA AND HERZEGOVINA, 2006



Source: Author's calculations from the Labour Force Survey 2006.

⁶ The reported percentages are based on the author's calculations from the LFS 2006. There are a number of problems with the income data. In particular, as noted above, incomes are notoriously underreported. However, if at least the relative distortion arising from underreporting is roughly the same across Entities, then the argument would still stand.

TABLE 3.4 | INCIDENCE OF INFORMAL ECONOMY EMPLOYMENT BY AGE, SEX AND ENTITY, BOSNIA AND HERZEGOVINA, 2006

	Age	Males	Females	Total
Bosnia and Herzegovina	15–24	52.3	46.9	50.4
	25–49	30.2	26.5	28.9
	50–64	32.8	33.9	33.2
	Total	34.4	32.1	33.6
FBiH	15–24	53.1	50.7	52.2
	25–49	26.4	24.0	25.6
	50–64	25.5	21.7	24.3
	Total	28.9	27.1	28.3
RS	15–24	51.8	40.4	48.2
	25–49	37.7	30.8	35.1
	50–64	45.3	48.5	46.5
	Total	44.0	39.8	42.4

Source: Author's calculations from LFS 2006 micro-data.

Interestingly, it may be observed that the incidence of informal employment is lower for women than for men. This is largely to do with the sectoral distribution of the informal economy and of male/female employment patterns. Women are slightly more likely than men to work in the informal economy in agriculture, but employment in agriculture accounts for around 20 per cent of employment overall in Bosnia and Herzegovina. In industry, which accounts for some 31 per cent of all employment, men are much more likely to work in the informal economy than women. The percentages of men and women working in the informal economy in services are broadly similar. So overall, there is a slightly higher incidence of informal employment among men.

With regards to unemployment, ILO-defined unemployment rates in Bosnia and Herzegovina are high (Table 3.5), but they fell significantly between 2006 and 2008, largely as a result of the good growth performance in those years. As is common in Central and Eastern Europe, unemployment rates are significantly higher for women than for men. Interestingly, the gender difference is much less marked in RS, despite the fact that women also have significantly higher labour force participation rates in that part of the country (Rosas et al., 2009: table 3, p. 16).

**TABLE 3.5 | UNEMPLOYMENT RATES BY GENDER AND ENTITY,
BOSNIA AND HERZEGOVINA, 2006–2008**

		2006	2007	2008
Total	Bosnia and Herzegovina	31.1	29.0	23.4
	– FBiH	32.4	31.1	25.0
	– RS	28.5	25.2	20.5
	– DB	37.1	40.0	31.9
Males	Bosnia and Herzegovina	28.9	26.7	21.4
	– FBiH	29.5	28.2	23.1
	– RS	27.6	23.8	18.2
	– DB	32.8	38.3	28.6
Females	Bosnia and Herzegovina	34.9	32.9	26.8
	– FBiH	37.5	36.4	28.3
	– RS	30.0	27.5	24.1
	– DB	45.2	42.9	38.2

Source: Agency for Statistics of Bosnia and Herzegovina (2009).

Employment rates also grew over the period 2006–08 in Bosnia and Herzegovina. However, in contrast to the reduced unemployment rates more or less evenly spread across the Entities, growth in employment rates was more marked in RS than in the FBiH. This reflects the fact that growing employment was accompanied by increases in labour force participation rates in RS, whereas in the FBiH, labour force participation rates for both men and women were stable or even slightly lower over the period.

**TABLE 3.6 | EMPLOYMENT RATES BY GENDER AND ENTITY,
BOSNIA AND HERZEGOVINA, 2006–2008**

		2006	2007	2008
Total	Bosnia and Herzegovina	29.7	31.2	33.6
	– FBiH	29.1	29.2	31.8
	– RS	30.9	35.1	37.3
	– DB	23.7	23.4	25.1
Males	Bosnia and Herzegovina	39.9	42.3	44.9
	– FBiH	40.3	40.9	43.3
	– RS	39.6	45.4	48.0
	– DB	33.7	30.6	34.9
Females	Bosnia and Herzegovina	20.0	20.8	23.1
	– FBiH	18.8	18.3	21.1
	– RS	22.7	25.4	27.2
	– DB	14.0*	16.4*	15.6

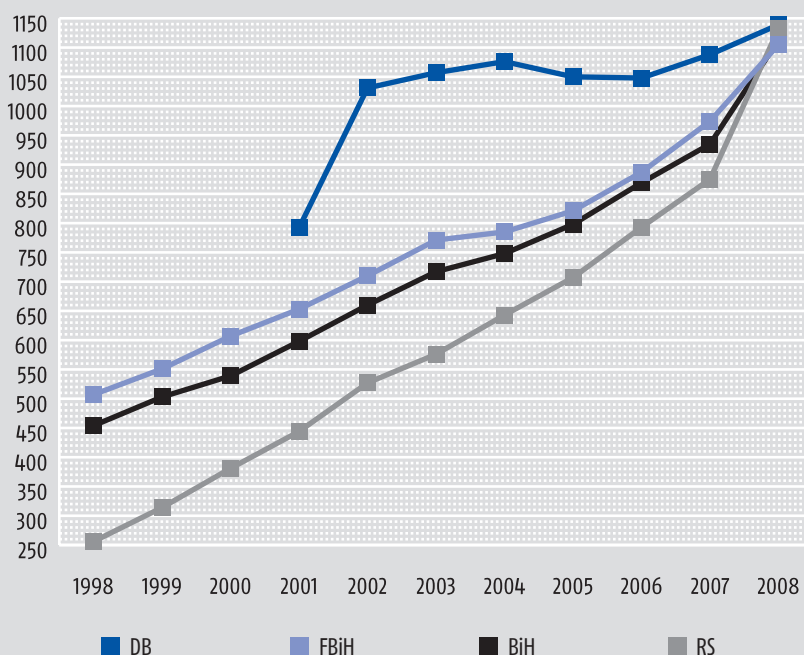
Note: For DB, percentages indicated by * are based on a sample which is too small to be statistically reliable.

Source: Agency for Statistics of Bosnia and Herzegovina (2009).

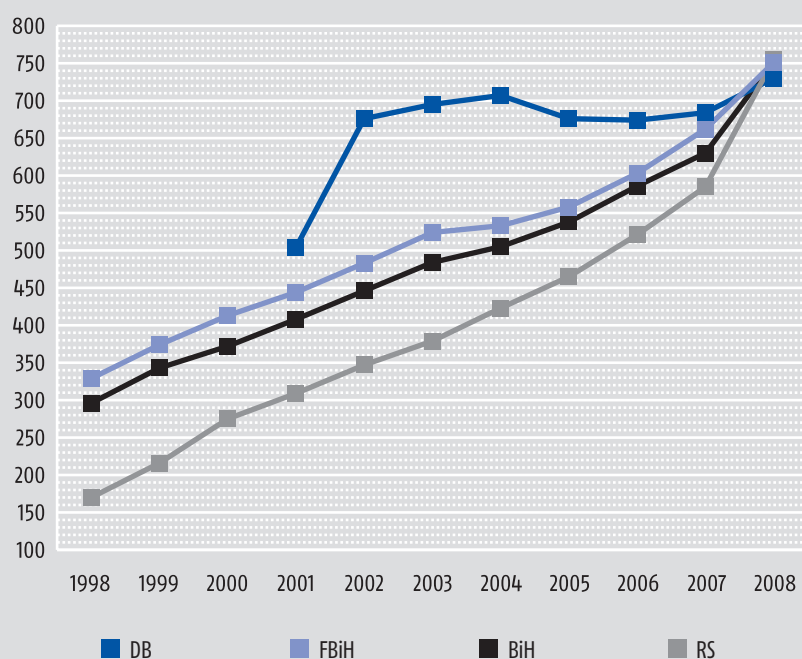
2 | Wage trends

Nominal wages have risen fairly rapidly in recent years (Figures 3.3 and 3.4) at a faster rate than both inflation and productivity (World Bank, 2005). There has also been a convergence between the Entities in terms of real wages which coincides with, and indeed actually exceeds, the convergence in GDP per capita (Figures 3.5a and 3.5b). Despite rapidly rising prices in RS, the alignment in wages is real, albeit much more modest than apparent from trends in nominal wages, and is not due solely to the differences in inflation between the Entities. Overall, real wages rose by just over 83 per cent in the FBiH and by just over 140 per cent in RS between 1998 and 2008. It may be observed that the rate of increase accelerated over the most recent 2006–08 period, in both nominal and real terms.

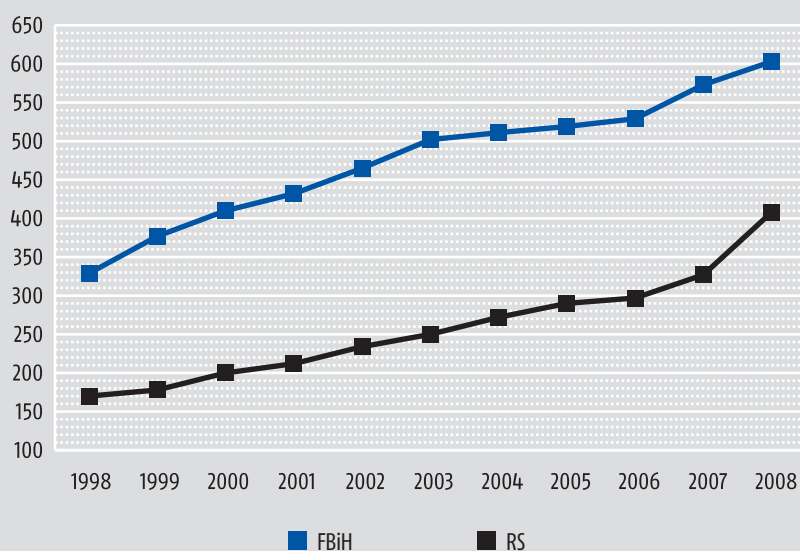
FIGURE 3.3 | AVERAGE MONTHLY GROSS WAGES, STATE AND ENTITIES, BOSNIA AND HERZEGOVINA, 1998–2008



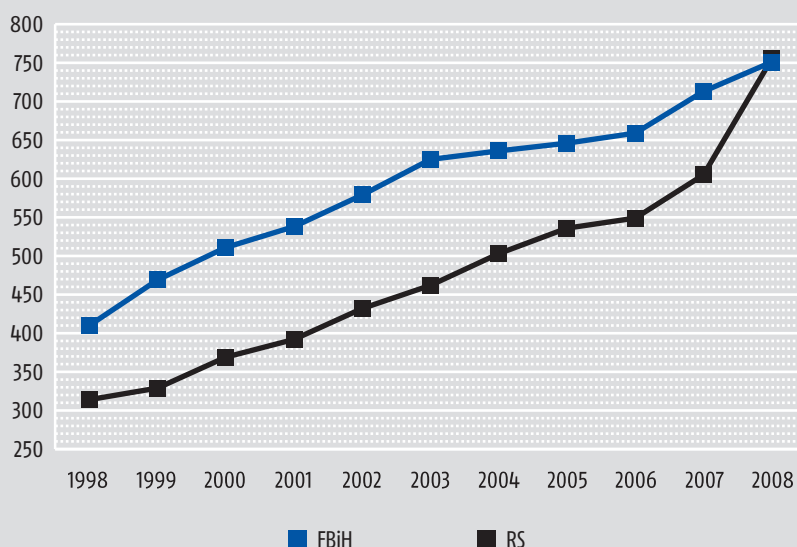
Source: Central Bank of Bosnia and Herzegovina (2009).

FIGURE 3.4 | AVERAGE MONTHLY NET WAGES, STATE AND ENTITIES, BOSNIA AND HERZEGOVINA, 1998–2008

Source: Central Bank of Bosnia and Herzegovina (2009).

FIGURE 3.5A | REAL NET MONTHLY WAGES, FBiH AND RS, 1998–2006 (1998 PRICES)

Source: Author's calculations based on CPI data from the Statistical Agencies of the FBiH (<http://www.fzs.ba/>) and RS (<http://www.rzs.rs.ba/>), various years.

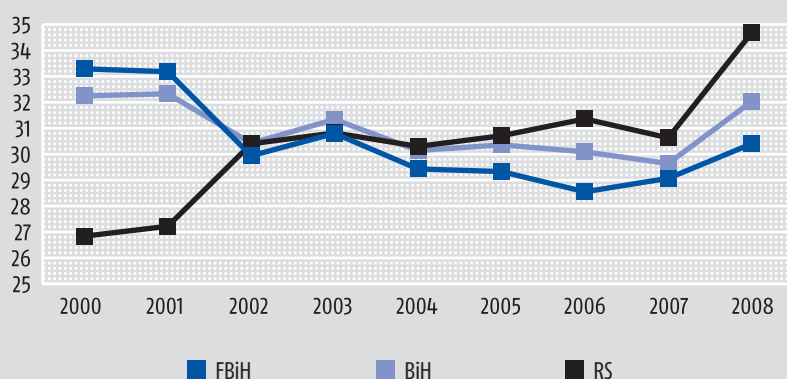
FIGURE 3.5B | REAL NET MONTHLY WAGES, FBiH AND RS, 1998–2006 (2008 PRICES)

Source: Author's calculations based on CPI data from the Statistical Agencies of the FBiH (<http://www.fzs.ba/>) and RS (<http://www.rzs.rs.ba/>), various years.

The adjusted wage share in national income (GDP) provides a rough indication of the division of national income between capital and labour. Figure 3.6 reports the wage share over the period 2000–2008, is based on registered employment, gross wages and GDP at market prices, while Table 3.7 reports that analogous information calculated on the basis of the Labour Force Survey (LFS) estimates of employment. Wage share also covers informal and self-employment which are not included in the registered employment figures that thus lead to larger estimates of the wage share. While one would expect the wage share based on registered employment to be lower than the corresponding estimate using LFS data, both displayed a similar trend during the short period when data became available for both estimates.

The longer trend shows that, in RS, the wage share has been growing since 2000, while in the FBiH the trend is in the opposite direction. In Bosnia and Herzegovina as a whole, there was an increase during the period 2006–09, which was, however much more marked in RS, than in the FBiH⁷.

⁷ One may also observe that, according to the LFS based estimates the increasing trend in FBiH is only observable over the period 2007–2009.

FIGURE 3.6 | ADJUSTED WAGE SHARE, BOSNIA AND HERZEGOVINA AND ENTITIES, 2000–2008 (BASED ON REGISTERED EMPLOYMENT AND WAGES)

Note: The estimated national wage share is not always between the estimates for the two Entities because the GDP figures are calculated from State and Entity GDP data, which are not always consistent.

Source: Author's calculations based on data provided by the State (<http://www.bhas.ba/>) and Entity Statistical Agencies, available on their websites (<http://www.fzs.ba/> for the FBiH and <http://www.rzs.rs.ba/> for RS), various years.

TABLE 3.7 | ADJUSTED WAGE SHARE, BOSNIA AND HERZEGOVINA AND ENTITIES, 2006–2009

	2006	2007	2008	2009
Bosnia and Herzegovina	36.6	36.5	40.1	43.1
– FBiH	36.2	35.0	37.3	39.6
– RS	36.1	40.5	46.7	50.5

Source: Author's calculations based on LFS data (Agency for Statistics of Bosnia and Herzegovina, 2009, 2010), gross wages (from the monthly Enterprise Survey) and GDP at market prices (from annual national accounts). The latter are both reported on the State (<http://www.bhas.ba/>) and Entity Statistical Agencies' websites (<http://www.fzs.ba/> for the FBiH and <http://www.rzs.rs.ba/> for RS), various years.

3 | Wage policies

3.1 | Building wage systems

As regards the application of international agreements on wage policies, on 2 June 1993, Bosnia and Herzegovina essentially ratified all the conventions previously ratified by the former Yugoslavia. In particular, it ratified the ILO wage-related conventions, including the Freedom of Association and Protection of the Right to Organize Convention, 1948 (No. 87), the Right to Organize and Collective Bargaining Convention, 1949 (No. 98), the Equal Remuneration Convention, 1951 (No. 100), the Discrimination (Employment and Occupation) Convention, 1958 (No. 111), the Minimum Wage Fixing Convention, 1970 (No. 131) and the Workers with Family Responsibilities Convention, 1981 (No. 156). However, Bosnia and Herzegovina failed to ratify the Protection of Wages Convention, 1949 (No. 95) and the Protection of Workers' Claims (Employers' Insolvency) Convention, 1992 (No. 173). Some issues have

been raised by the ILO's Committee of Experts with regard to the practical application of the conventions. In particular, regarding freedom of association, the Committee of Experts noted unacceptably long delays in the authorization of the establishment of workers' and employers' organizations at the state level and has suggested amendments to the State law to allow for the free establishment of such organizations.^{8, 9}

The minimum wage (MW) covered by Convention No. 131 is currently set by General Collective Agreements in both Entities. In compliance with labour law provisions, the social partners at branch and sectoral level regulate the base "labour price" in branch collective agreements, as well as the coefficients by which the labour price is multiplied for individual working posts. In case a worker's wage calculated in this way is nominally lower than the one fixed by the GCA on the minimum wage, the worker receives the guaranteed minimum wage of 320 KM.

3.2 | From self-management to collective bargaining

Bosnia and Herzegovina's system of collective bargaining traces its roots to the former Yugoslav system of self-management. Under self-management, there were few private companies. Wage and employment conditions were set mainly by the central Government and trade unions, with Government setting the firm's wage bill by social considerations. The intra-enterprise income redistribution, in terms of individual worker wages and benefits, was then decided collectively within the company's overall wage allocation. The 1988 Yugoslav Enterprises Act effectively abolished self-management and introduced the right of an employer to lay-off workers, albeit generally at high cost. With regard to wage determination, the act introduced a system of new provisions through laws, collective agreements and incomes policy to replace the self-managed system. A Yugoslav Labour Code was adopted in 1989 and fostered the role of collective bargaining in wage determination. Subsequently within Bosnia and Herzegovina, the Entities introduced their own Labour Codes in 2000, which were supplemented by General Collective Agreements (GCAs). In both FBiH and RS, employers are free to form or join any employers' association, and employees are free to form or join any union. However, there is a need to further develop tripartism because of the embryonic state of the conventional private sector. Collective bargaining is also weak as there are no trade unions organizing the private sector. The way in which collective agreements are determined has generally preserved and, in most cases, upgraded the employment conditions of workers in the formal economy, but with practically no provision for workers outside the formal economy, including the unemployed. In theory, all employers public and private are bound by the provisions in the General Collective Agreements in the Entities. In practice, while it is generally understood that all employers are bound by the GCAs, effective coverage of the branch collective agreements outside the broadly defined public sector has been limited, especially in the private sector (World Bank, 2005).

There is a provision in the FBiH Labour Law which states that the Federal Minister can extend the validity of the collective agreement. However, the Federal Minister has not yet extended a collective agreement to date. The RS law is more cryptic, stating that agreements are "mandatory" for those

⁸ In the meantime, the issue with the authorization of the employers' organization was solved.

⁹ Over time, there has been a series of comments by the Committee of Experts to this end, most recently in the *Report of the Committee of Experts on the Application of Conventions and Recommendations* (CEACR2007), 78th Session.

who were represented in the negotiation process. In practice, the currently valid GCAs have economy-wide coverage, while branch collective agreements are largely limited to State-owned enterprises and privatized former State-owned sectors.

3.3 | Divergence and then convergence on minimum wage

Minimum wage setting is an area where the two larger Entities differ markedly, in terms of regulations and, until recently in the minimum wage levels. In the FBiH, the minimum wage was established in August 2005 by the General Collective Agreement (GCA). It stood at 1.75 KM per hour, which corresponded on the basis of a standard working month of 176 hours, to a net monthly wage of 308 KM – around 55 per cent of the average net wage. By fixing a specific level of the minimum wage, the 2005 GCA marked a change in direction. Until that time, the minimum wage in the FBiH had been indexed at 55 per cent of the average net wage. In RS, a minimum wage was established for the first time in March 2006 at 205 KM per month or around 40 per cent of the average wage. The minimum wage was established on a monthly, as opposed to an hourly, basis and revised annually. Before that time, RS had a legally non-binding “minimum price of labour”, which at the end of 2005 stood at 82 KM (around 19 per cent of the average net wage) per month, and which, more or less, remained from 2000 until the change.

Currently, the minimum wage in the two Entities is almost equal. In the FBiH, the minimum wage, established in April 2008, stands at 1.95 KM per hour or 343.20 KM per month. This corresponds to around 43 per cent of the net average monthly wage in the FBiH in June 2009. In RS, the minimum wage was revised in December 2008 for 2009, and now stands at 320 KM per month or 40 per cent of the net average monthly wage in June 2009. Thus, as with average wages, minimum wages have also converged in the two Entities. Since 2006, the minimum wage has remained more or less at around 40 per cent of average net wages in RS. On the other hand, in the FBiH, the minimum wage, as a percentage of the average wage, has been progressively dropping since 2005, from 55 per cent of the average wage to the current level of around 43 per cent. In addition to originally rather different levels of the minimum wage – a gap which has now more or less disappeared – RS sets a monthly rather than an hourly minimum, something that has certainly contributed to the very low level of part-time employment in the Entity – 8.7 per cent of those employed as opposed to 15.0 per cent in the FBiH (as measured by the 2006 LFS).

3.4 | The effects of the minimum wage

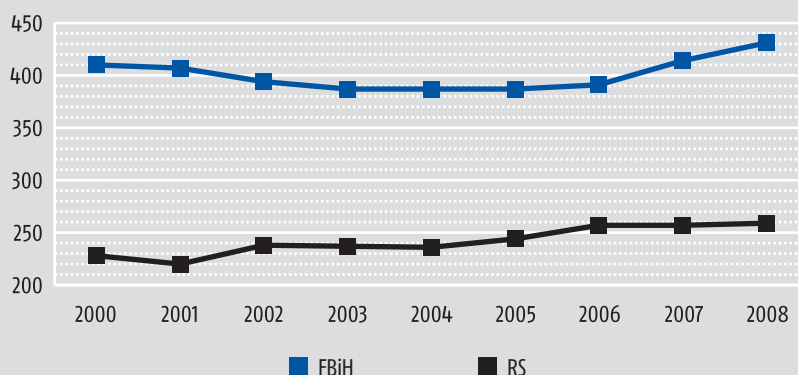
Given the history of originally divergent minimum wages, one might expect that the minimum wage would have had a greater impact on wage compression and therefore a more detrimental employment impact in the FBiH than in RS. However the fairly detailed analysis of wage distributions reported by the World Bank (2005) suggests that the wage distribution around the mean in the FBiH, at least on the basis of the LSMS, appeared to be almost identical to that found in RS. The implication is that the informal economy in the FBiH allows employers to pay lower wages, as well as avoid employment protection legislation and tax and social insurance contributions, while in RS wages in the informal economy are more comparable to those of formal economy workers. However, although the study found significant differences between formal and informal economy wages in 2001 and 2002 in the FBiH, and

no such corresponding differentials in RS, this difference had practically disappeared by 2003. This is also supported by the author's calculations based on the 2006 Labour Force Survey which reported that the average informal economy monthly wage in the FBiH was around 57 per cent of the formal economy wage. However, in RS, the proportion was 78 per cent. The implication of all this is that the minimum wage does not seem to be an important obstacle to employment growth in the country, although, like employment protection legislation, it may have some impact on the distribution of employment.

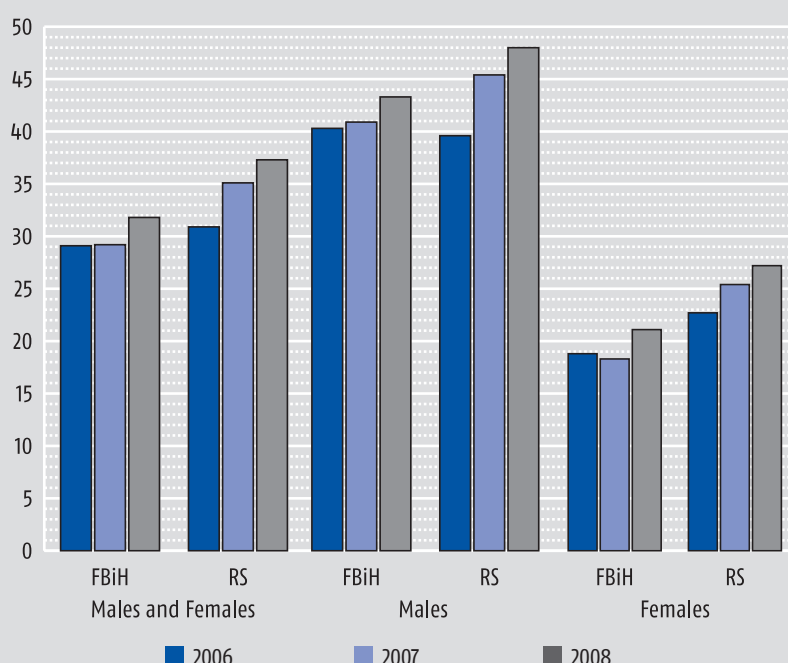
It is also worth examining evidence provided by trends in employment over the period 2000–08 (Figure 3.7). It will be observed that registered employment in RS rose between 2005 and 2006 – continuing a trend observable since 2004 – despite the introduction of the minimum wage in RS in early 2006. On the other hand, as minimum wages subsequently continued to rise in RS and fell relative to the average wage in the FBiH, formal employment rose relatively quickly in the FBiH and much more modestly in RS.

However, it may be recalled from Table 3.6 that, between 2006 and 2008, employment rates were growing in both the FBiH and RS. Figure 3.8 illustrates these trends. In contrast to registered employment figures, the employment rate increases as a whole were much more marked in RS than in the FBiH. If minimum wage changes were driving variations in employment, one would expect precisely the opposite trend. In the FBiH, the minimum wage was gradually falling as a percentage of the average wage over the period; whereas in RS, an effective minimum wage was introduced in early 2006 and was then progressively raised as a percentage of the average wage. This brought the minimum wage in RS closer to the one in the FBiH. But employment growth was also much stronger in RS among women, who, given their lower wage rates – considered further below – would be more likely to be affected by minimum wage provisions. Certainly, once again, the – albeit purely descriptive – evidence does not point towards a strong detrimental effect of minimum wages on employment. Thus, the changing minimum wage, falling in the FBiH and rising in RS, does not seem to have played a significant role in affecting overall employment levels, which have grown in both Entities. Indeed, overall employment has grown faster in RS, where the minimum wage went up, than in the FBiH, where it was headed downward.

FIGURE 3.7 | REGISTERED (FORMAL ECONOMY) EMPLOYMENT IN THE TWO ENTITIES, 2000–2008



Source: Based on data provided by the State and Entity Statistical Agencies. Available at: <http://www.fzs.ba/> for the FBiH and <http://www.rzs.rs.ba/> for RS.

FIGURE 3.8 | EMPLOYMENT RATES, BOSNIA AND HERZEGOVINA AND ENTITIES, 2006–2008

Source: Based on data from Agency for Statistics of Bosnia and Herzegovina (2009).

However, comparison of formal employment data from the Enterprise Surveys and overall employment data from the LFS for the period 2006–08 does suggest some role for the minimum wage in affecting the distribution of employment between the formal and the informal economies. Specifically, monthly Enterprise Surveys demonstrate that formal employment rose by just over ten per cent in the FBiH and by just under one per cent in RS between 2006 and 2008. In contrast, the LFS reports that, overall formal and informal employment rose by less than six per cent in the FBiH and by more than 17 per cent in RS. There may be several explanations for these differences including perhaps differences in data collection and estimation methodologies. However, one possible explanation which is consistent with the above information is that employment growth in RS was largely coming from growth in informal employment, whereas the opposite was true in the FBiH. Again, this suggests that, although not driving employment as a whole, the rising minimum wage in RS may have played a role in shifting the distribution of employment between the formal and informal economies. There are certainly competing explanations for this – such as tax rate variations as mentioned below, but it remains the case that, even in the presence of the major hike in minimum wages in RS in early 2006, formal employment continued its upward trajectory.

3.5 | Payroll taxes and contributions a determinant factor for labour markets

Payroll taxes and contributions are probably far more significant than the minimum wage in determining labour market outcomes in Bosnia and Herzegovina. Here again, there are significant differences in policy between the FBiH and RS. Taxes and social contributions are levied at different rates and on different measures of income. However, these differences are, to a degree, more apparent than real in terms of their impact on overall labour costs and the consequent “tax wedge”, which is the percentage of total labour costs that involves tax and social security contributions. The World Bank calculates that the tax wedge, as conventionally measured (namely as a percentage of total labour costs) in 2004 was 34 per cent in both the FBiH and RS. This is lower than all other countries in South-East Europe, apart from Albania, where the wedge is a couple of percentage points below that amount (World Bank, 2005). The choice of wage is important since in the FBiH, non-wage benefits and allowances are not subject to taxes or contributions; and, since the value of these is fixed and therefore independent of income, as income rises so too does the tax wedge. Nevertheless, given the relatively high wage rates in Bosnia and Herzegovina, in comparison to its neighbours, the existing tax wedge is likely to be a significant factor in pushing firms towards the informal economy – far more so than the minimum wage. This is in line with recent findings in both OECD countries (for example, OECD, 2006) and the Europe and Central Asia regions (Rutkowski et al., 2005), which suggest that higher payroll taxes especially when combined with the “business climate” in Central and Eastern Europe are much more significant factors than either employment protection legislation or minimum wages in determining employment levels.

Moreover, the World Bank Study points out that, despite the fact that contributions are notionally proportional in both Entities, the tax wedge in the FBiH is actually progressive in nature and goes up with the wage, whereas in RS the wedge is purely proportional which means that it rises in proportion to wages. Progressivity in the FBiH occurs because allowances are not taxed and, since they are largely fixed sums – independent of the wage – the percentage of effective income exempt from taxation drops as income rises. A more recent analysis by Arandarenko and Vukojevic (2008) notes that, until 2006, the tax wedge in RS was essentially regressive. By 2007, it had become roughly proportional or very slightly progressive. On the other hand, in the FBiH, the tax wedge, including allowances was significantly progressive, although not necessarily at lower incomes. Given the lower wages paid in the informal economy, this is at last a much stronger explanation of the pattern of informal economy employment observable in the country.

On 1 January 2007, the flat rate income tax of ten per cent was introduced in the RS, and in the FBiH as of January 1, 2009.

3.6 | Still high – although diminishing – discrimination

As regards the implementation of legislation on discrimination in employment in conformity with Conventions No. 100 and No. 111, a Gender Equality Act was adopted at the Bosnia and Herzegovina State level in 2003 and laws prohibiting discrimination exist also at the Entity levels, although, again, there are some issues with the practical application of the law. In particular, as regards the Convention on Equal

Remuneration, 1951 (No. 100), the Committee of Experts (CEACR, 2009) has observed that the absence of separate wage rates for the same or similar work is not sufficient to apply the Convention. In addition, equal remuneration should apply also to different work of equal value. This implies the objective job evaluation to determine the tasks involved and recently the Committee of Experts (CEACR, 2009) asked the Bosnia and Herzegovina Government to provide specific information on the steps which had been taken. In September 2006, a Gender Action Plan was adopted (Gender Equality Agency of Bosnia and Herzegovina, 2006) in order to address a range of issues and much progress was made. However, the Committee of Experts has noted that, two years after the adoption of the plan, “there continues to be discrimination against women in terms of access to better paid positions” (CEACR, 2008). Moreover, the Committee has also raised concerns about the widespread discrimination against the Roma people.

Unfortunately, data on employment and wages by gender are not included in the reports on formal employment based on the Enterprise Survey. However, the Labour Force Surveys do provide such information, and analysis of the data from 2006 may be used to throw some light on gender differences and issues related to informal employment and public–private pay differentials, which are also not included in the published reports on formal employment and pay (Table 3.8). The table provides information on monthly wages for full-time employees aged 15–64 by gender and some basic job characteristics based on data from the 2006 Labour Force Survey, which includes questions on salaries and allowances. Given the notorious unreliability of self-reported income, it may be considered merely indicative as regards absolute levels, but it is likely to be reasonably reliable regarding the relative levels of salaries by gender, Entity and type of employment.

TABLE 3.8 WAGES OF FULL-TIME EMPLOYEES (EXPRESSED IN KM) BY TYPE OF OWNERSHIP AND EMPLOYMENT CONTRACT, BOSNIA AND HERZEGOVINA, 2006				
	FBiH		RS	
	Males	Females	Males	Females
Ownership Public/mixed	856.46	838.16	683.73	569.64
Ownership Private	699.27	560.06	457.11	376.57
Employment form Formal	815.42	752.00	594.18	501.74
Employment form Informal	546.18	361.03	510.10	328.03

Source: Author's calculations on the basis of the LFS 2006 (weighted data).

The table makes interesting reading. First, gender differentials are stronger:

- in RS than in the FBiH;
- in the private sector than in the public sector; and
- in the informal than in the formal economy.

Second, in line with the findings of the World Bank (2005) analysis mentioned above, wage differentials between the formal and informal economies are much stronger in the FBiH than in RS.

The issue of gender discrimination can be investigated further. Simple Mincerian regressions of wages were undertaken for males and females separately and used to arrive at a Blinder-Oaxaca decomposition into components to explore the different treatment experienced by men and women

and where discrimination exists. This involves regressing wages on variables representing the level of education and experience of individuals. Separate regressions are run for men and women so that the effects of education and experience are estimated separately. The difference between the observed wages of men and women can then be decomposed into three components

(a) If men on average have higher levels of education than women, one would expect the wages of men to be higher. This would not imply any kind of discrimination;

(b) If men advance more quickly in their careers and/or are paid more for work of similar worth, this may be interpreted as discrimination;

(c) a third term which is essentially an interaction between the two previous effects.

One may observe, on the basis of the regression results (Table 3.9) moderate differences in the returns to different levels of education between the sexes which are strongest for those with relatively high or low levels of education. Indeed, a larger difference in the returns to education exists between the FBiH and RS that is not based on gender. One might observe that returns to education are very weak in the informal economy, bearing in mind the much smaller sample size. For males in the FBiH, there seems to be a major difference between those with no education – the default category – and those with at least elementary education. The major difference between the sexes seems related to potential experience. In both the formal and informal economies across the Entities, the effect is much stronger in the informal economy and the returns to education are much stronger for men than for women.

As regards the extent of discrimination (Table 3.10), one may observe that, with the exception of informal employees in the FBiH, gender discrimination accounts for the lion's share of the entire observed gender wage differential. Even in the informal economy in the FBiH discrimination is responsible for more than 90 per cent of the differential. The implication is that, in the absence of gender wage discrimination, women would be paid more than men in Bosnia and Herzegovina, based on their education and experience. Some caveats should be applied here. The major source of discrimination appears to arise from differences in the returns to potential experience. Potential experience is precisely that – potential. It is the estimated number of years since leaving school and does not refer to actual work experience. In general, women spend less time in the labour market due to the inevitable interruptions associated with child-bearing and caring. So, one might think of these effects as being the returns to age rather than experience per se. Moreover, given the relatively poor quality of the wage data, one would not wish to overemphasize the results. On the other hand, the evidence, such as it is, is very clear. There are very substantial differences in the wages of men and women, particularly in the private sector and above all in the informal economy. These differences are very clearly attributed to differences in the returns to education and age, rather than to differences between men and women in their average age or, more particularly, average level of education. The findings are also in conformity with the observations of the Committee of Experts, that women are absent from "better paid" positions. Specifically, the poor career progression of women as a whole implies lower returns to age, experience and education for females – which is precisely the findings of the statistical analysis. Such overwhelming evidence of discrimination is hard to refute and would certainly bear further investigation.

TABLE 3.9 | OLS ESTIMATION OF MINCERIAN WAGE EQUATIONS SEPARATELY BY ENTITY AND BY TYPE OF EMPLOYMENT CONTRACT, BOSNIA AND HERZEGOVINA, 2006

		FBiH				RS			
		Males		Females		Males		Females	
		coeff	std. error	coeff	std. error	coeff	std. error	coeff	std. error
Formal Economy									
Work experience	Potential Experience	0.02	0.00	0.01	0.01	0.01	0.01	0.00	0.01
	Potential experience squared(/100)	-0.03	0.01	-0.01	0.02	-0.01	0.02	0.03	0.02
	Experience in current job	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.00
Education	Elementary	0.15	0.14	-0.17	0.21	-0.36	0.17	-0.64	0.25
	Lower secondary	0.16	0.14	-0.13	0.21	-0.29	0.16	-0.36	0.25
	Upper Secondary	0.26	0.14	0.10	0.21	-0.05	0.17	-0.07	0.25
	High school	0.44	0.15	0.44	0.21	0.08	0.18	0.08	0.26
	University	0.77	0.15	0.63	0.21	0.52	0.18	0.55	0.25
	Intercept	6.11	0.14	6.20	0.21	6.15	0.17	6.00	0.25
	R-squared	0.11		0.17		0.17		0.24	
N	1577		805		698		483		
Informal Economy									
Work experience	Potential Experience	0.03	0.01	0.02	0.02	0.06	0.02	0.03	0.03
	Potential experience squared (/100)	-0.08	0.04	-0.05	0.06	-0.11	0.04	-0.05	0.09
	Experience in current job	-0.01	0.01	-0.01	0.01	-0.01	0.01	-0.02	0.01
Education	Elementary	0.97	0.44	-0.08	0.63	-0.05	0.36	0.76	0.81
	Lower secondary	1.08	0.43	-0.13	0.65	0.15	0.36	0.38	0.81
	Upper Secondary	0.98	0.44	-0.02	0.65	0.26	0.38	0.50	0.84
	High school	0.97	0.50	0.42	0.72	0.85	0.51	1.21	0.84
	University	1.48	0.48	1.30	0.89	1.29	0.49	1.08	0.88
	Intercept	4.83	0.45	5.74	0.66	5.32	0.38	4.85	0.76
	R-squared	0.08		0.05		0.16		0.07	
N	231		79		118		56		

Note: Statistical significance is indicated by bold and italics for $p < .01$, by bold for $.01 < p < .05$ and by italics for $.05 < p < .10$

TABLE 3.10 | BLINDER-OAXACA DECOMPOSITION OF GENDER WAGE DISCRIMINATION, BOSNIA AND HERZEGOVINA, 2006

	Estimated wage differential (KM)	% explained by discrimination
Formal economy FBiH	64.22	138.5
Formal economy RS	73.50	132.5
Informal economy FBiH	138.33	91.8
Informal economy RS	126.63	112.6

Note: Estimates of discrimination are based on a three-way decomposition (including interaction effects).

4 | After-effects of the crisis

Although it is a little early to obtain a full picture of the effects of the global financial crisis on Bosnia and Herzegovina, it is already evident that the crisis has had significant repercussions for both the economy as a whole as well as for wages and wage fixing mechanisms in particular.

It now appears that the global crisis is having serious real effects on the Bosnian economy, in contrast to what was written in the early analyses of the event.¹⁰ While earlier estimates spoke of much reduced or even zero GDP growth for 2009, the most recent IMF report (IMF, 2010a) suggests a contraction of real GDP in 2009 of more than three per cent (Table 3.1). Results from the April 2009 Labour Force Survey suggest that unemployment rates overall and particularly for males rose between 2008 and 2009, but fell for females (Table 3.11). To some extent, this reflects tendencies observable throughout Europe, with the main burden of the crisis falling on males (European Commission, 2009). However, there is a little more to this story.

The Labour Force Survey reports that female employment rates rose significantly from 27.2 per cent to 29.4 per cent between 2008 and 2009 in RS, but fell slightly from 21.1 per cent to 20.7 per cent along with labour force participation rates from 29.4 per cent to 28.7 per cent in the FBiH. Thus, the explanation for falling female unemployment rates in the FBiH lies in the diminished labour force participation for females, whereas in RS, it would appear that, to some extent, female employment substituted for male employment. Since formal employment in RS dropped over the period for both males and females – for example, between September 2008 and September 2009 formal employment also fell by 3.6 per cent for males and by 1.8 per cent for females (RS Statistical Agency, 2008, 2009, <http://www.rzs.rs.ba>). The most plausible explanation for the increased female employment rates observable in the Labour Force Survey data lies in the expansion of informal employment. Indeed, this is also supported by anecdotal reports by the social partners, considered further below.

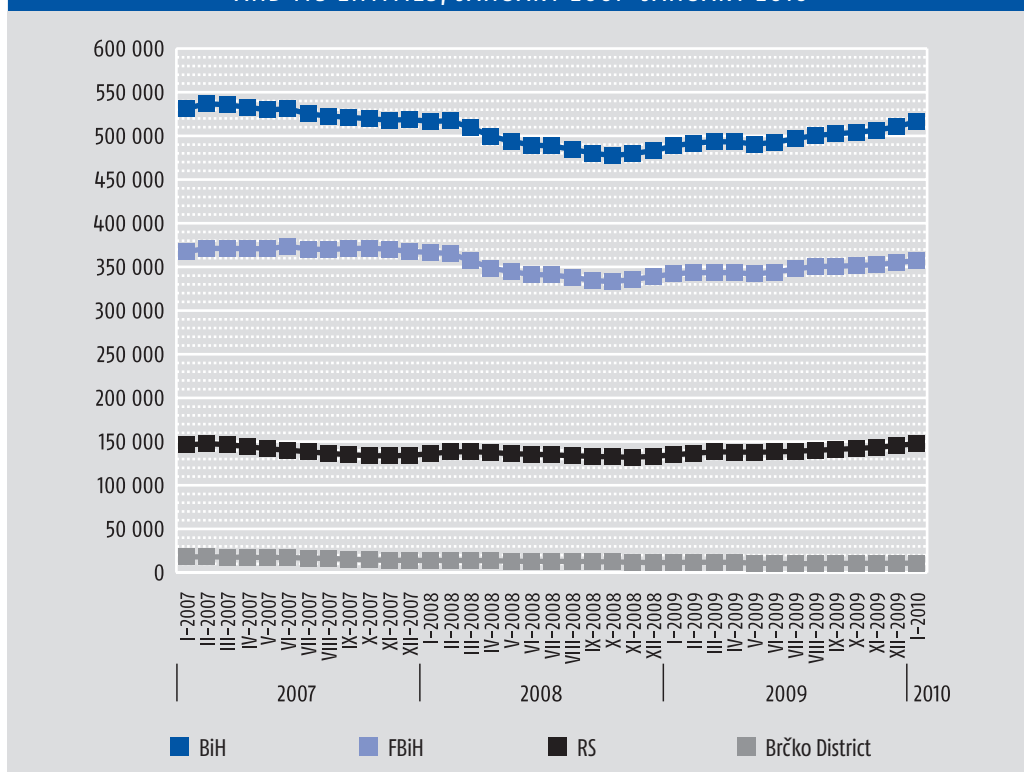
Data on registered unemployment also support the notion of a moderate but significant increase in unemployment as a consequence of the crisis (Figure 3.9). It also suggests that registered unemployment, which had been falling more or less consistently since early 2007, began once again to rise from around October/November 2008.

¹⁰ Kozarić (2009), for example, suggested that the global crisis represents a very limited threat to the Bosnian economy and, in particular, that the crisis had not impacted the Bosnian banking sector and financial stability. The EPRU (2009) talks of decelerating growth in 2009, rather than contraction.

TABLE 3.11 | UNEMPLOYMENT RATES IN BOSNIA AND HERZEGOVINA AND ENTITIES, 2008 AND 2009

		2008	2009
Total	Bosnia and Herzegovina	23.4	24.1
	– FBiH	25.0	25.7
	– RS	20.5	21.4
	– DB	31.9	29.2
Males	Bosnia and Herzegovina	21.4	23.1
	– FBiH	23.1	24.4
	– RS	18.2	20.6
	– DB	28.6	29.5
Females	Bosnia and Herzegovina	26.8	25.6
	– FBiH	28.3	27.9
	– RS	24.1	22.4
	– DB	38.2	28.8

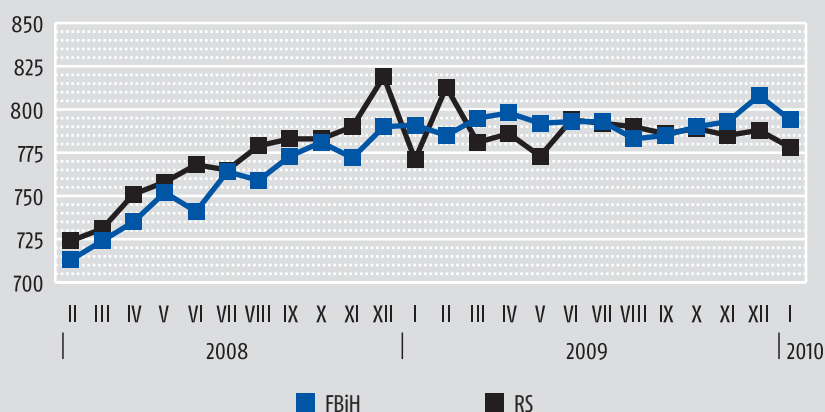
Source: Agency for Statistics of Bosnia and Herzegovina (2010).

FIGURE 3.9 | REGISTERED UNEMPLOYMENT IN BOSNIA AND HERZEGOVINA AND ITS ENTITIES, JANUARY 2007–JANUARY 2010Source: Data from the Labour and Employment Agency for Bosnia and Herzegovina's website. Available at: www.arz.gov.ba

5 | The impact of the crisis on wage trends

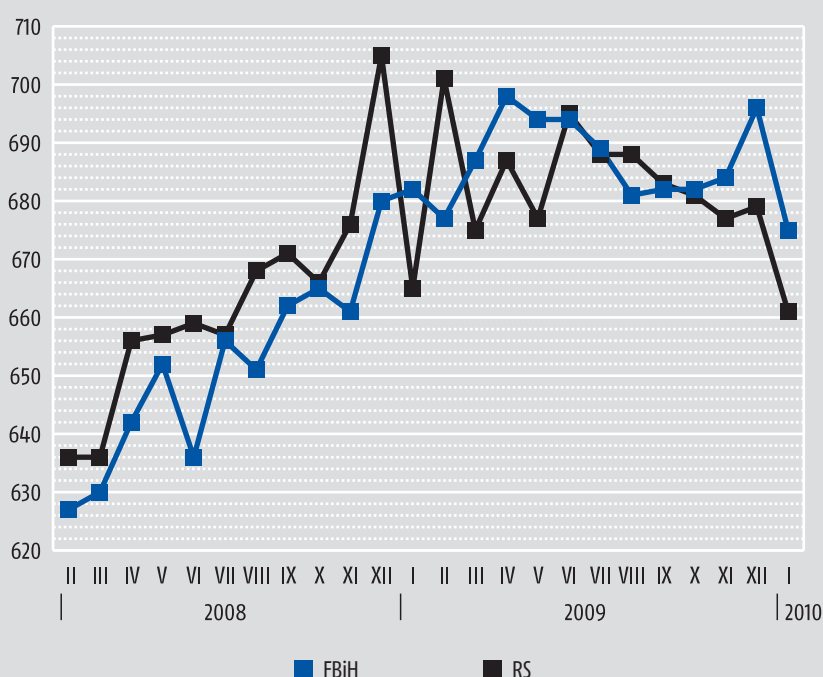
Although the effects of the financial crisis on wages are likely to be felt over an extended period, it is worth looking at trends in nominal (Figure 3.10) and real (Figure 3.11) net wages so far. After a period of steady growth through 2008, there was a discernable levelling off in nominal wages in 2009. Indeed, in RS a modest decline in nominal wages is observable from June 2009 onwards. Given the relatively low levels of inflation over the period, the trend in real wages is similar. Here, the decline in real wages is discernable in both Entities even if one ignores the seasonal December 2009 pay hike in the FBiH. It is likely, particularly with the fiscal crisis in the FBiH and the IMF's pressures, that wages over the near future will also start to decline.

FIGURE 3.10 | NET MONTHLY NOMINAL WAGES, FBiH AND RS, FEBRUARY 2008–JANUARY 2010



Source: Based on data provided by the State and Entity Statistical Agencies. Available at: <http://www.fzs.ba/> for the FBiH and <http://www.rzs.rs.ba/> for RS.

FIGURE 3.11 | NET MONTHLY REAL WAGES, FBiH AND RS, FEBRUARY 2008–JANUARY 2010 (2005 PRICES)



Source: Author's calculations based on data provided by the State (CPI) and Entity (nominal wages) Statistical Agencies. Available at: <http://www.fzs.ba/> for the FBiH, <http://www.rzs.rs.ba/> for RS and <http://www.bhas.ba/eng/> for the State Agency.

Two further developments of relevance to the discussion of the impact on wages of the global financial crisis are worth mentioning. First of all, in the FBiH, the global crisis has exacerbated the already difficult situation regarding public finances. Secondly, as a consequence of the crisis, the Bosnia and Herzegovina government agreed to a three-year Stand-By Arrangement with the IMF in the amount of 1.2 billion Euros (€), which will be discussed further in Section 6.

6 | Wage policy reactions

The crisis has clearly put pressure on the collective bargaining agreements operating in the country, particularly in the FBiH where government finances were already being squeezed. As already noted, in July 2009, the State government signed a Stand-By Arrangement with the IMF to provide €2 billion over a three-year period (IMF, 2009b). The Stand-By Arrangement added to the existing pressures to reduce public expenditure and to adopt wage restraint in the public sector in the FBiH. Indeed, at the time of writing, the IMF is threatening to withhold the second instalment to both Entities because of the failure of the FBiH to comply with fiscal targets (MacDonald, 2010). Although not a direct result of the Stand-By Arrangement much controversy surrounded the proposal of an “Intervention” Law in the FBiH aimed at

reducing public expenditure and the public sector wage bill by ten per cent. The proposed law included an article (Article 11) stating, “in case the provisions of the Laws and other regulations and agreements – general and branch collective agreements – governing the rights to wages, allowances and current grants are opposed to the provisions thereto, the provisions of this last shall apply”. In other words, the draft law included a provision allowing for the suspension of collective bargaining agreements. In the face of opposition from workers’ representatives, the law was passed under the title “Law on the Manner of Making Savings” (FBIH Official Gazette No. 52/09, 10 August 2009) in August 2009 without this provision.

In practical terms, savings have been made on the provision of meals and allowances and for the present – as shown in the figures above – average wages have not yet been significantly reduced in the FBiH. However, the Law also provides for the reduction of wages, and negotiations have been initiated between the Confederation of Independent Trade Unions (SSSBIH) and the Employers’ Association with a view to amending the General Collective Agreement.

In general, it appears that the main effects of the recession have been felt, at least initially, in terms of reduced hiring and increased job separation rather than wages. In RS, the workers’ organizations report an increase of 80 per cent in separations for reasons associated with “technological surplus” – that is, due to insufficient demand. Dismissals have primarily hit lower skilled workers in processing, trade, catering and construction. Also in RS, the Government has introduced a wage subsidy of 50 KM (around €25) per worker per month in the sectors hardest hit by the crisis, such as textiles, leather and footwear, on the condition that firms pay wages and social security contributions in full. Indeed, there are some reports, particularly in RS, that the recession has led to an increase in problems associated with the non-payment of contributions and allowances by employers as well as wage arrears. Indeed, although there is no published information on the issue, a general understanding appears to exist among workers’ representatives and government officials that the recession has led to increased informal economic activity, and indeed, the conditionality of the wage subsidy mentioned above was in part aimed at preserving formal employment.

Also, workers’ and employers’ organizations in Bosnia and Herzegovina generally recognize that sex discrimination in employment and wages exists, particularly as regards to access to managerial employment. But general agreement seems to exist among both parties that the recession has affected men and women equally.

7 | Conclusions and policy issues

A number of relevant issues have arisen in the analysis of wages and wage policy presented above.

Data issues – There are several ways for data to be significantly improved in order to have an accurate assessment of a country’s situation:

- **Population:** the last population census was undertaken in 1991, before the war in Bosnia Herzegovina. The lack of reliable knowledge on the current state of the population seriously impedes any analysis of employment and wages in the country and urgently needs to be addressed.

- **Data collection:**

- Income data are no longer collected as part of the Labour Force Survey. Although such data are subject to error and in many countries Labour Force Surveys do not include income data, it would be advisable that individual survey-based income data be collected in order to complement the Enterprise Survey, which provides information only on formal employment.

- The Labour Force Survey is carried out on an annual basis. It would be advisable as soon as possible to move towards a quarterly or even continuous Labour Force Survey in line with other countries in the region.

- **Data reporting:** even within the existing system of data collection, much could be done to improve the existing reporting of information. In particular, although undoubtedly collected in the Enterprise Survey, wage and employment data are not reported separately for public and private enterprises, nor even separately for males and females. Provision of this further information would involve no substantial cost and significantly improve the information content of existing published series on employment and wages. Data from the Labour Force Survey could be used to report the extent of informal versus formal economy employment.

Wage differentials – The analysis has shown strong evidence of gender discrimination in wages. More generally, wage differentials between public and private firms, between informal and formal economies, and between the Entities are issues which should be subject to closer and more regular investigation. Even with available data sources, as already noted, improvements could be made, with only minor adjustments in reporting.

Implications of the global crisis – So far, the effects of the crisis have been felt primarily in terms of reduced employment, with relatively modest, albeit discernible, effects on wages in the formal economy. However, the evidence and experience suggest that real wage reductions will be progressively more significant in the near future, possibly with an impact on low pay. The minimum wage has a role to play without giving rise to adverse effects on employment, as documented in this chapter. Moreover, it is generally understood that informal economy activity has increased as a consequence of the recession, although systematic information is not generally available to document this as yet. In practice, it would not be difficult to investigate this with existing data sources – for example, using the Labour Force Survey. However, in practice, as noted above, information on the informal economy is not routinely reported. While evidence of gender discrimination in wages was presented above, there are no strong reasons to suppose that the crisis has affected women more severely than men. Indeed, the available evidence suggests somewhat the opposite. Unemployment rates actually fell for women between 2008 and 2009, the LFS reports, and their employment rates dropped only slightly in the FBiH, while increasing in RS. Given that registered employment went down for men and women in both Entities, this further supports the notion of an expanding informal economy as a crisis response, with the concomitant negative effects on earnings and working conditions.

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The Impact of the Crisis on Wages in selected Balkan Countries

4 The former Yugoslav Republic of Macedonia: Is the present wage setting mechanism an effective policy tool?

NIKICA MOJSOSKA-BLAZEVSKI

1 | Introduction

The following is a detailed analysis of wage developments in the last two decades in the former Yugoslav Republic of Macedonia. A specific focus is being applied to recent years and specifically the impact of the recent 2008 global economic crisis.

Wage developments are explored in conjunction with the national wage policy in order to understand the implications of a more structured wage-setting mechanism for workers and employers as well as the society as a whole.

Several areas can be identified for improvement. The first is the lack of available and accurate wage data to allow for high quality analysis of wage developments and wage inequalities in the country.

The second area is the inadequate wage-setting mechanism in the public and private sectors. In the public sector, no general framework for wage negotiation and bargaining exists and wage setting

regulations lack consistency. The collective bargaining process and the payment of wage supplements is generally unsatisfactory in the public sector. Furthermore, those working for the Government are split between those designated as civil servants for specific wage regulations and others – the police, defence, customs and other segments – who are in a separate non-civil service payment category.

Although the wage setting mechanism in the public sector contains strict regulations on the enforcement of wage supplement payments government institutions have managed to “evade” this law.

In particular, we shall see in this chapter that wage developments in public administration are primarily driven by political considerations in the absence of a regular indexation formula.

Wage fixing and collective bargaining in the private sector also have their drawbacks. Since the wage setting process there is left to the social partners, there is hardly any legal coverage for wages due to the prevalence of small and micro firms in the Macedonian economy. The main issue is the absence of a statutory minimum wage, which has been replaced by “irrational” legislation, such as a required minimum floor for payment of social contributions and required minimums for average wages at the company level. We shall analyze the pros and cons of a statutory minimum wage in this context and also consider the need for a better-structured wage system.

Surprisingly, the latest worldwide economic crisis did not have a negative impact on the labour market or on wage trends in the former Yugoslav Republic of Macedonia, despite the modest GDP decline in the first three quarters of 2009, followed by a recovery at the end of the same year. This might suggest that either employment in the country is adjusting slowly to production (perhaps because of strict limitations on firing workers) or that the recent reduction in labour taxes has managed to provide private firms with sufficient room to manoeuvre during the crisis.

2 | Economic developments before the crisis (1990–2007)

2.1 | GDP, employment and wage developments

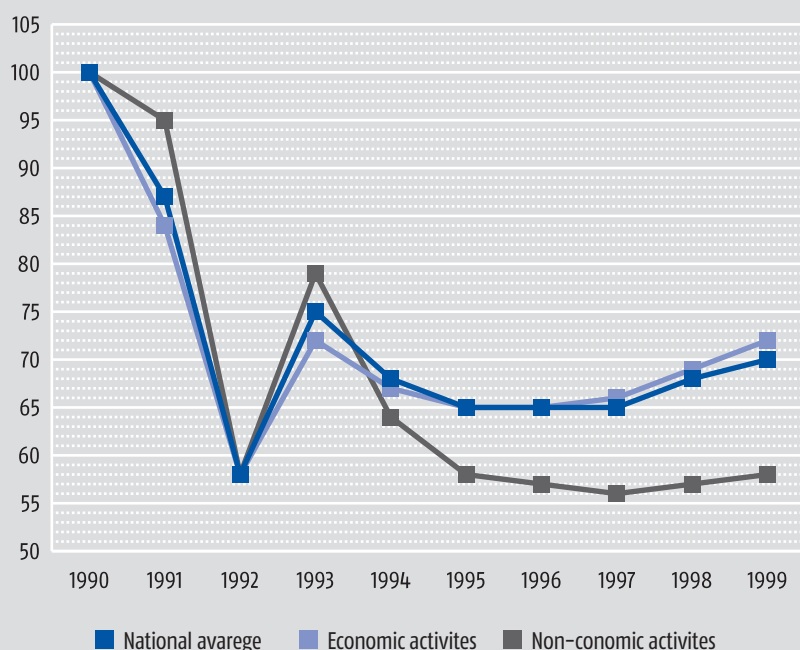
2.1.1 | Jobless growth?

The first years of transition in the former Yugoslav Republic of Macedonia (1990–1994) witnessed a relatively high GDP decline (expressed in 1995 constant prices), of 5.5 per cent, in comparison to other countries in Central and Eastern Europe. But employment adjustments to this major decline in GDP lagged behind, with an employment drop of only 1.3 per cent during the same period. As a result, productivity also fell in that period.

The recovery that started in 1995 was fairly modest, with a real GDP growth of 1.8 per cent on average per annum – which meant that the pre-transition GDP level was reached only in 2006. In this period, as in other transition economies (see Boeri, 2001), employment in the former Yugoslav Republic of Macedonia did not grow as much as increased production, especially compared to neighbouring countries.

From 1990 to 1999, wages also increased substantially in nominal terms along with high inflation, but the average wage declined in real terms (see Figure 4.1).

FIGURE 4.1 | NATIONAL, ECONOMIC AND NON-ECONOMIC SECTOR, REAL AVERAGE WAGE INDEX, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 1990–99 (1990=100)



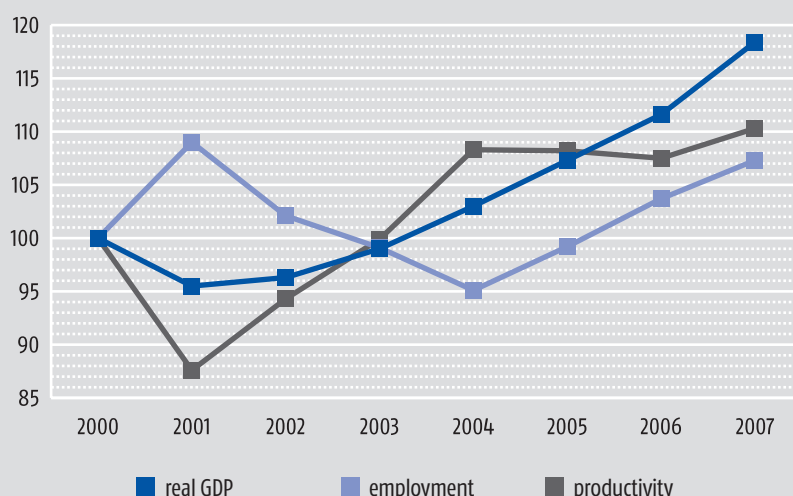
Source: Author's calculations based on Statistical Yearbook, State Statistical Office, various years.

The real GDP growth rate in the period 2000–07 was 2.8 per cent on average and remained positive each year except in 2001, when the country experienced civil unrest which ended at the end of the year. If data from 2001 are excluded, average GDP growth rose to 3.8 per cent¹ in the period, which is still lower than in the other countries covered in this book. Figure 4.2 shows real GDP and employment developments during this time. While output started to recover immediately after the period of civil unrest, employment fell for three consecutive years thereafter. This is related to the unrest-related increase in employment in 2001, as well as the privatization process which was quite extensive in this period.²

¹ The year 2001 creates difficulties in the analysis of employment and productivity developments since, despite declining GDP in that year, employment was nine per cent higher in comparison to the previous year because of increased (temporary) employment in the army and defence. Hence, we should treat it as an outlier.

² The usual clause in privatisation agreements between the state and the private investor was a restriction on lay-offs for about two years. Hence, the effect on employment from labour rationalization (due to initial labour hoarding) comes with a lag of a similar length in time.

FIGURE 4.2 | REAL GDP, EMPLOYMENT AND PRODUCTIVITY INDEX, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2000–2007 (2000=100)



Source: Authors' calculations based on LFS and national accounts, different years.

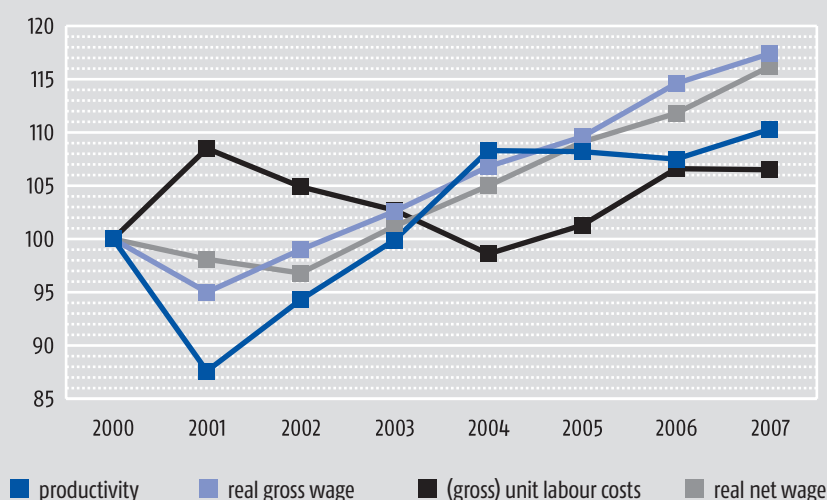
2.1.2 | Modest productivity gains

Real GDP per employed person – that is, productivity – has followed an upward trend since 2001, with stagnation in 2005–06. Figure 4.2 enables us to distinguish three periods/phases with regard to productivity developments. In the first period, 2001–04, productivity growth was achieved by employment decline coupled with more modest GDP growth. Indeed, Angel-Urdinola and Macias (2008) discovered that productivity gains were achieved mainly by the destruction of unproductive jobs (via massive labour-shedding programmes) rather than through the creation of productive jobs. In the second period, 2005–06, productivity stagnated since employment and GDP shared similar rates of growth. In the last period (2007), productivity growth was achieved through higher GDP growth, accompanied by an increase in employment when the economy moved away from jobless growth. The overall productivity gains of ten per cent from 2000 to 2007 (or 17 per cent from 2002 to 2007) were rather modest.

2.1.3 | Real wage growth

In the analysed period, real wage growth exceeded productivity growth, except in 2004 (see Figure 4.3). This might be explained by expectations of higher inflation, which led to annual wage increases. The ratio of the real gross wage to productivity – that is, the unit labour costs – increased and this limited job creation.

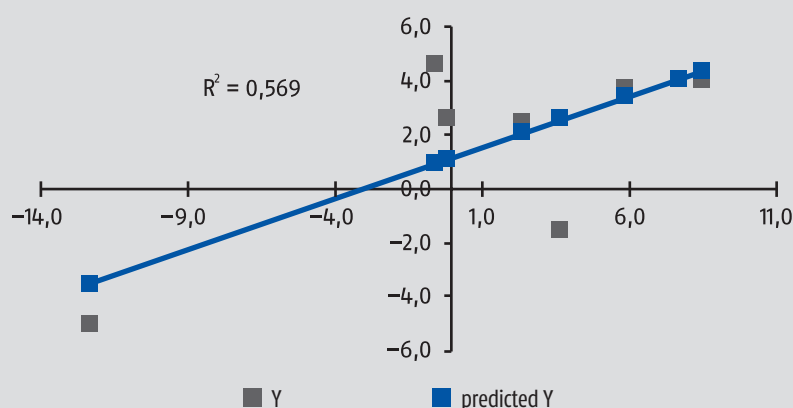
FIGURE 4.3 | PRODUCTIVITY, REAL WAGES AND UNIT LABOUR COSTS, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2000–2007



Source: Authors' calculations based on LFS, national accounts and employment and wages survey, different years.

The correlation coefficient between the real gross wage growth and productivity growth of 0.57 in the period 2000–07 reveals a rather weak relation between the two. Figure 4.4 presents predicted values for real gross wage growth when it is regressed on productivity growth. This demonstrates that productivity is an important predictor of real wages and that it accounts for 57 per cent of overall variation in real gross wage growth. Nonetheless, there are additional important factors in place which account for as much as 43 per cent of the total variation.

FIGURE 4.4 | ACTUAL VS. PREDICTED REAL GROSS WAGE GROWTH, THE FORMER YUGO-SLAV REPUBLIC OF MACEDONIA 2000–2007 (REGRESSED ON PRODUCTIVITY)



Source: Author's own calculations.

2.1.4 | Tax wedge discouraging employment creation

In addition to increasing unit labour costs, the relatively high tax wedge which represents the difference between the gross and net wage,³ also discouraged job creation. In the past decade, however, it decreased on three occasions because of tax system changes. In particular, the coefficient between the real gross and net wage declined from 1.76 in 2000 to 1.69 in 2001, when a progressive personal income tax (PIT) system with two separate tax rates (of 15 and 18 per cent) was introduced. In 2007, the Government introduced a flat PIT and profit tax system with a constant tax rate of 12 per cent that declined from 15 and 18 per cent for the PIT and from 15 per cent for the profit tax. In 2008, the flat rate further declined to ten per cent. As a result, the gross to net wage coefficient dropped to 1.66 in 2007 and to 1.63 in 2008. In 2008, the growth rate of net wages was, for the first time, higher than the growth rate of gross wages, which suggests that the reduced personal income tax rate was generally used for raising workers' wages instead of reducing labour costs. The ratio was further reduced in 2009, when the social contribution rates were lowered (see Section 4.4).

2.1.5 | A decreasing labour share

In terms of allocating national income between workers and the owners of capital, GDP (income) data from national accounts published by the State Statistical Office of the former Yugoslav Republic of Macedonia show that the share of labour income (including social contributions) in GDP declined from 45.1 per cent in 2003 to 35 per cent in 2007 (according to the most recent available data). At the same time, the share of capital income in GDP increased from 23 per cent in 2003 to 32 per cent in 2007. This might suggest that the relative position of labour to capital worsened in the period under analysis. However, this collection of data is incomplete as these same households also received non labour income from various expanding sources such as held equity, interest and investment earnings. In addition, a reduced tax wedge stemming from lowered personal income tax rates provides a false picture of a worsened labour position.

2.2 | Labour market specificities in the former Yugoslav Republic of Macedonia

Wage policy and wage developments must be analysed in terms of the specificities of the overall labour market situation and especially the size of the informal economy, high unemployment and low labour force participation. In this respect, net international migration outflows and the sizeable informal economy can be viewed as adjustment mechanisms.

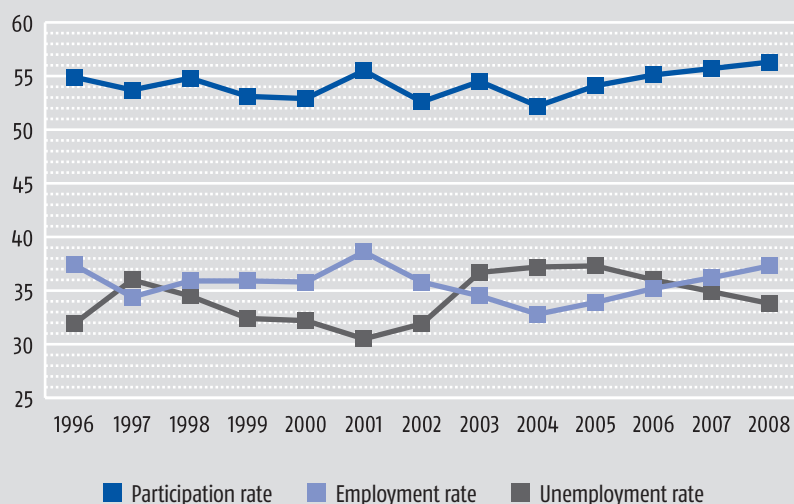
2.2.1 | Low participation and high unemployment

The main sources of labour market data include the Labour Force Survey (LFS) which is compiled by the State Statistical Office (SSO) and the administrative registration of the unemployed by the Employment

3 Until 2009, payroll taxes were paid by employers.

Service Agency. The LFS, which provides comparable data from other countries, was conducted for the first time in 1996 and has been collected on a quarterly basis since 2004.

FIGURE 4.5 | LABOUR MARKET DEVELOPMENTS DURING THE TRANSITION PERIOD, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 1996–2008



Source: State Statistical Office, LFS, various years.

As Figure 4.5 shows, the labour force participation rate has remained low and relatively stable, with notable improvements in the most recent period in 1996–2008 when the overall participation rate increased by 2.9 per cent. More specifically, the female participation rate in 2008 stood at 50.2 per cent which is, 26.4 percentage points lower than the male participation rate.

The former Yugoslav Republic of Macedonia's employment rate in 2008 was two-thirds of the EU27 average which represents a positive but quite moderate upward trend in the 1996–2008 period. The overall employment rate increased by 2.1 per cent (0.8 percentage points). The gender gap is also quite large in employment, equalling about 18 percentage points in 2008.

The country is suffering from very high unemployment – 34 per cent in 2008 – which is almost equally distributed between the genders. Unemployment was already high at the outset of the transition period, or early 1990s, at an estimated 20 per cent before employment losses occurred alongside a modest rise in the participation rate. Since 2006, unemployment has declined modestly. Nevertheless, registered unemployment is higher than the LFS measure of unemployment because the health insurance system offers incentives for inactive persons and informal economy workers to register as out of work. All registered unemployed individuals who have no other entitlement for obtaining health insurance (such as an employed spouse or parents) are entitled to free health care.

High non-wage labour costs are among the reasons for high unemployment. In particular, labour taxes, social security contributions and non-wage costs relative to productivity raise unemployment by: (i) driving companies into the informal economy which exhibits lower output and employment growth

than the regular economy; and (ii) increasing total production (labour) costs, which limits the demand for labour.

2.2.2 | Widespread informal economy

The most recent estimates show that the share of the informal economy in GDP between 2004 and 2005 has gone up to 36.9 per cent (Schneider, 2007). This figure is comparable to the share of informality in neighbouring countries (such as Bulgaria, Serbia and Croatia). The State Statistical Office's "adjusted" GDP data for 2007 indicates that the informal sector (largely the under reported trade, construction and manufacturing sectors) constituted 17.2 per cent of calculated GDP.

Studies have found that the informal labour market remains sizeable and quite active. This might explain the high and persistent unemployment figures. Although few studies exist in this area, Schneider (2002) determined that the informal labour force in 2001–02 contained 35.1 per cent of the working-age population, which largely exceeded the sectors in other CEE countries. An analysis conducted by the World Bank (2007) reached a similar conclusion by estimating that the share of informal employment is 32.9 per cent. Other studies such as the one by Jackman (2007) found evidence of widespread informal employment among officially unemployed individuals, with estimates ranging from one-third to one-half of the pool of the unemployed. This is in line with the considerable number of registered and long-term unemployed persons in the country, with 50 per cent in uninterrupted unemployment for four years or more.

High labour costs, relatively rigid legislation and its weak enforcement represent the main factors for persistent informal employment. This should begin to change with the wage system reforms of 2009 (see Section 4) which reduced labour costs and improved personal income tax and social contribution collection.

3 | Wage dynamics before the crisis (2002–2008)

3.1 | Sectoral variations behind national wage developments

The national average gross wage in nominal terms in 2008 was 46 per cent higher than in 2000 and 37.8 per cent higher than in 2002.⁴ In the period 2002–08, average wages in agriculture rose by 20 per cent, whereas the average wage in industry and services increased by about 32 per cent (see Table 4.1).

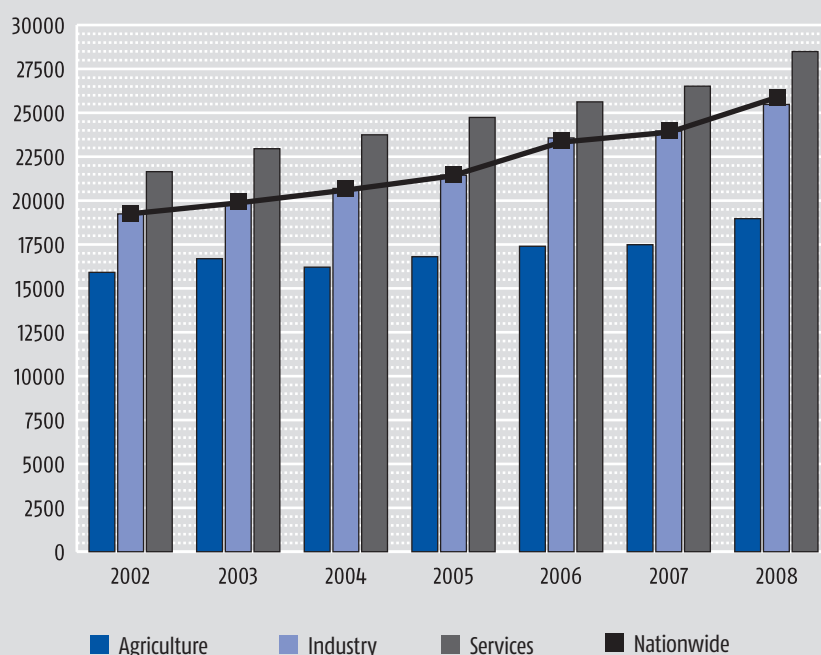
⁴ In this section, we analyse wage growth for the period 2002–08 because national classification of branches was changed in 2002 and data prior to that year are not precisely comparable.

**TABLE 4.1 | NOMINAL NET AND GROSS WAGE,
THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2002–2009**

Nominal gross wages	2002	2003	2004	2005	2006	2007	2008	2009	Change 2002–2009	Annualized wage growth
Nationwide	19,030	19,957	20,779	21,335	23,037	24,139	26,228	29,922	57.2	7.2
Agriculture	14,437	14,100	17,287	19,128	19,485	17,755	17,342	19,318	33.8	4.2
Industry	19,243	19,854	20,692	21,450	23,570	23,965	25,478	29,040	50.9	6.4
Services	21,648	22,955	23,748	24,737	25,624	26,520	28,492	33,050	52.7	6.6
Primary sector	15,914	16,692	16,209	16,804	17,401	17,488	18,973	21,843	37.3	4.7
Fisheries	12,959	11,507	18,366	21,452	21,569	18,021	15,711	16,793	29.6	3.7
Mining	21,726	22,483	23,350	24,811	26,805	27,007	28,841	30,558	40.7	5.1
Manufacturing	16,703	16,949	17,746	17,501	18,079	19,271	20,586	20,650	23.6	3.0
Utilities	24,667	25,363	25,970	27,116	32,787	32,231	33,401	42,275	71.4	8.9
Construction	13,876	14,619	15,702	16,373	16,608	17,352	19,083	22,677	63.4	7.9
Trade	18,222	20,035	20,807	21,987	22,676	23,006	23,908	26,001	42.7	5.3
Hotels and Restaurants	14,680	15,513	17,463	18,190	18,795	19,020	20,602	22,848	55.6	7.0
Transport and Communication	24,097	24,819	25,688	27,292	28,865	29,321	31,555	38,026	57.8	7.2
Financial Intermediation	38,009	40,588	43,531	45,251	46,149	46,981	49,494	53,569	40.9	5.1
Real Estate, Renting and Business Activities	23,289	24,095	22,768	22,883	23,068	24,339	25,860	30,092	29.2	3.7
Public Administration	19,618	21,853	23,177	26,232	28,089	29,147	32,465	37,043	88.8	11.1
Education	18,396	19,468	19,570	19,693	20,844	22,956	24,938	29,847	62.2	7.8
Health and Social Works	18,610	19,909	20,202	20,342	20,924	21,759	24,480	32,622	75.3	9.4
Other Services	19,906	20,315	20,526	20,759	21,211	22,158	23,131	27,400	37.7	4.7
Nominal net wages	2002	2003	2004	2005	2006	2007	2008	2009	Change 2002–2009	Annualized wage growth
Nationwide	11,279	11,824	12,293	12,597	13,517	14,584	16,096	19,957	76.9	9.6
Agriculture	8,910	8,612	9,975	11,407	11,653	10,653	10,697	13,089	46.9	5.9
Industry	11,245	11,767	12,269	12,718	13,977	14,542	15,766	19,293	71.6	8.9
Services	13,016	13,546	13,994	14,546	15,040	16,076	18,960	22,131	70.0	8.8

Annual wage growth at national level in the respective period was 5.4 per cent, while average wages in agriculture went up by 2.9 per cent, and wages in industry and services increased by 4.6 and 4.5 per cent per year, respectively.

FIGURE 4.6 | AVERAGE GROSS WAGE BY SECTOR,
THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2002–2008



Source: Author's calculations based on wage data from the State Statistical Office, different years.

Figure 4.6 reveals that from 2002 to 2008, the average wage in agriculture followed an increasing and a then decreasing trend. Overall however, the relative living standards of agricultural workers declined. In particular, the share of the average wage in agriculture in 2002 was 76 per cent of the national average wage, whereas in 2008 it stood at only 66 per cent. The same holds true for industrial workers whereas the relative position of workers in the service sector improved.

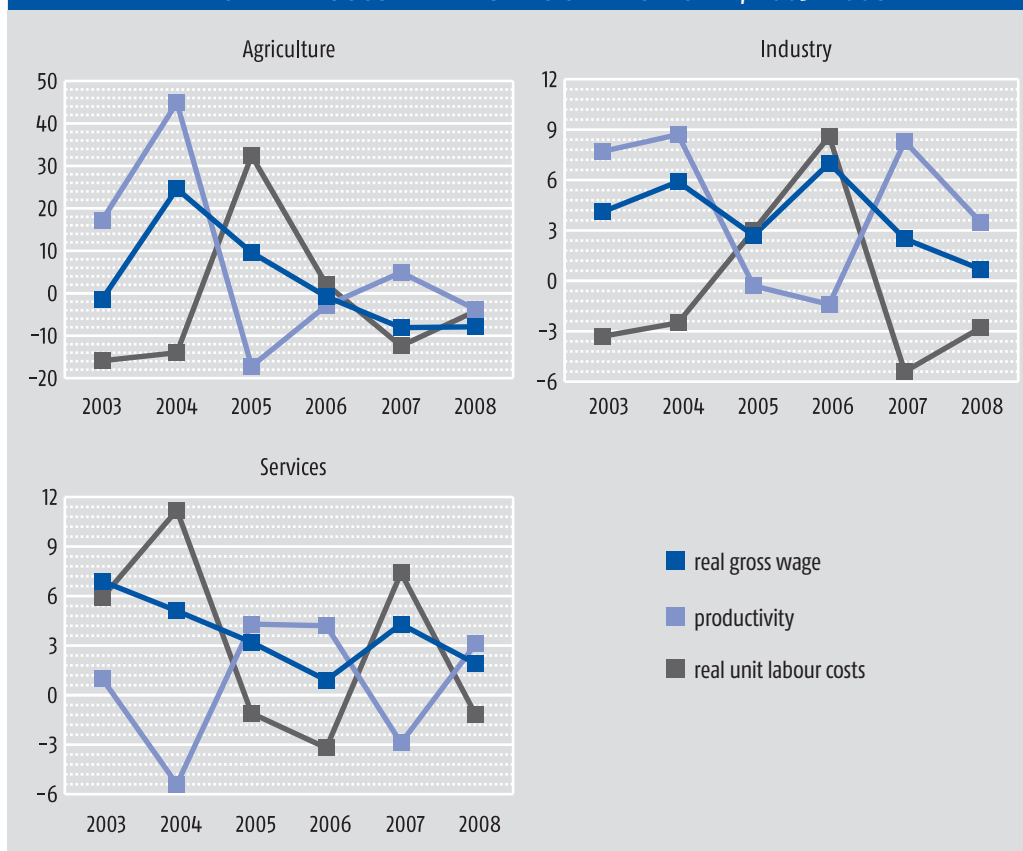
Figure 4.7 shows the growth rates of real gross wages, productivity and unit labour costs in agriculture and industry and services from 2003 to 2008. The graph does not indicate a direct link between real gross wages and productivity in agriculture which could explain the high variation in unit labour costs. In the most recent period, from 2007 to 2008, there was a declining productivity due to a large 11 per cent increase in agricultural employment,⁵ five per cent increase in unpaid family workers and a stable real gross wage which resulted in increasing labour costs.

Industrial production and productivity started to improve in 2006. Productivity growth in industry remained positive two years later, even though at a lower rate. Real gross wages in industry experienced positive growth rates in the whole period although there was a considerable reduction of growth

⁵ Agricultural employment in 2007 declined substantially in comparison to the previous year, and in 2008 it reached the 2006 level again. This is a fairly volatile category of employment although this rise might be related to increased agricultural subsidies.

between 2006 and 2008. As a result of these movements, real unit costs started to decline in 2006 and experienced negative growth in 2007 and 2008.

FIGURE 4.7 | GROWTH RATES OF REAL GROSS WAGES, PRODUCTIVITY AND UNIT LABOUR COSTS, BY SECTOR, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2003–2008



Source: Author's calculations based on wage data from the State Statistical Office, different years.

In the service sector productivity declined mainly because of larger employment growth while the real gross wage had positive growth. In the most recent period there was productivity growth together with a gross wage decline which led to a drop in unit labour costs.

Among the 15 branches, the greatest real wage growth between 2002 and 2008 was recorded in public administration, with 56.2 per cent growth overall, or eight per cent annualized wage growth. This growth largely occurred because of the decompression of the wage scale for public sector employees, as well as the 10 per cent wage increase across the board in October 2007 and 2008 (see Section 4). High wage growth was also reported in hotels and restaurants (33.9 per cent over the period), construction (29.7 per cent) and utilities and education (27.9 per cent).

3.2 | Wage disparities

3.2.1 | Compressed top-down disparity

Table 4.2 shows that about 18.5 per cent of wage earners received wages in 2007 that were below two-thirds of the median wage, which is the threshold for defining low-paid workers.⁶ This represents a considerable decline from 25 per cent in 2000. Females make up a majority of those low wage earners, with about a quarter of female workers receiving wages lower than two-thirds of the median wage. In comparison, only 13.5 per cent of males are paid at such a low rate. This gender difference might result from the concentration of females in certain lower wage occupations or branches. Female workers for instance dominate the textile industry where wages are less than half of the national average wage.

**TABLE 4.2 | DISPERSION OF HOURLY WAGES,
THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2007**

	All	Males	Females
Low pay incidence*	18.49	13.51	25.01
Decile 5/decile 1	1.80	1.95	1.60
Decile 9/decile 1	3.40	3.50	3.00
Decile 9/decile 5	1.89	1.80	1.88

Note: * Wages less than two-thirds of the median wage.

Source: Author's calculations based on 2007 LFS data.

The wage deciles show that the wage structure is quite compressed, since workers in the top decile earn only 3.4 times more than workers in the bottom decile. Wage compression is even higher for females, with a ratio of only 3. Lehman (2009) provided a comparative analysis of wage dispersion in transition and EU-15 countries, including the former Yugoslav Republic of Macedonia, and found that wage dispersion in the latter in 2007 was similar to that of Poland and Hungary at the beginning of the transition.

⁶ The analyses presented in this section are based on micro data from the LFS 2000, 2006 and 2007 which were made available to the author and should be taken with a caution. Calculations are made only for workers with the status of employee.

TABLE 4.3 AVERAGE HOURLY WAGE BY DIFFERENT WORKERS' CHARACTERISTICS, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2007

	Average hourly wage in MKD denars		
	Women	Men	Total
Total	58.5	65.5	62.8
Age group			
15–24	52.0	60.8	57.5
25–34	54.0	62.0	58.7
35–54	59.5	66.4	63.7
55–64	69.3	70.0	69.8
Education			
Primary or less	38.2	54.1	49.8
Secondary	49.9	62.1	57.4
University	90.0	93.9	92.0

Note: Data only cover persons with employee status.

Source: Author's own calculations based on LFS 2007.

3.2.2 | A significant gender pay gap

Table 4.3 clearly shows that female employees earn a lower average hourly wage than male employees by about 11 per cent. However, this can be regarded as an 'unadjusted' wage gap that not only reflects gender discrimination but also other factors since we did not control for education, sector of employment, firm ownership and so on. Similarly the SSO 2008 publication "Women and men in the former Yugoslav Republic of Macedonia" indicates that men's net average wage in 2006 was 27.4 per cent⁷ higher than women's average wage. The greatest gender wage gap (of 20 per cent and higher) is in agriculture, manufacturing, trade, hotels, health and social work. This is a relatively large difference in comparison to the EU-27 where the average gap is 15 per cent. The gap is also higher in rural areas and among workers with primary or a lower level of education.

What are the determining factors?

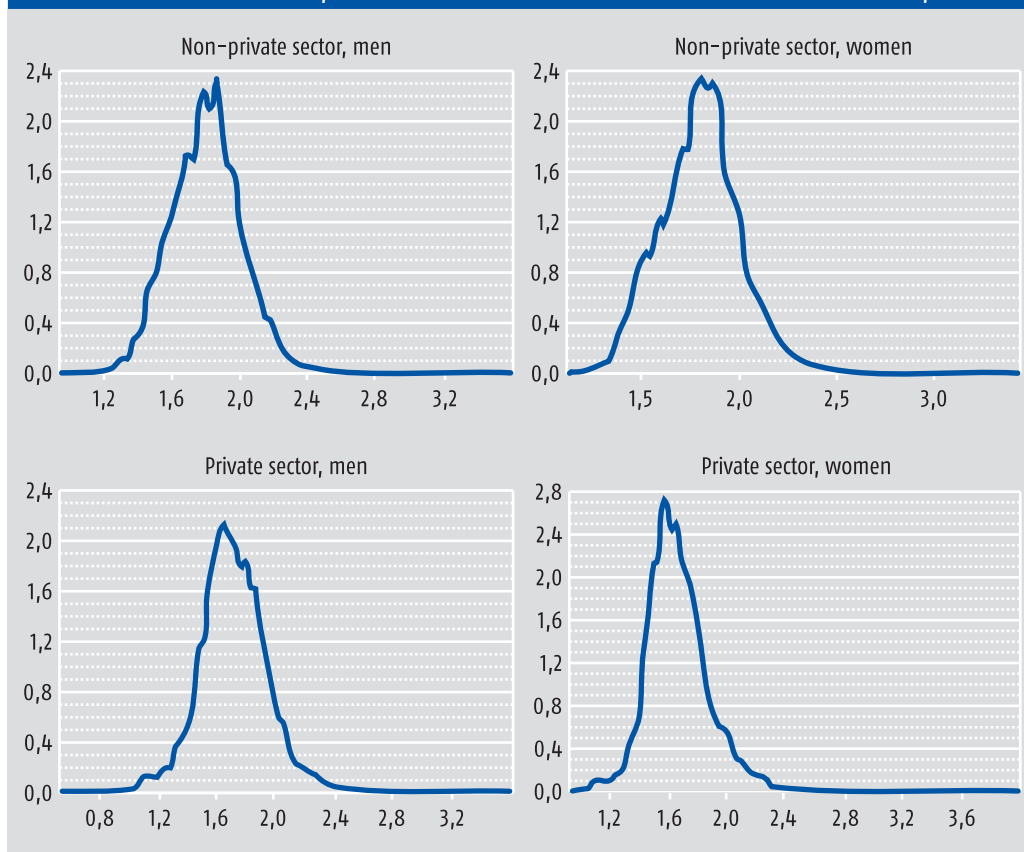
The wage differential by gender might result from the tendency of women to be overrepresented in certain occupations or branches that pay lower wages, or from differences in the number of hours worked by female employees, or it might point to gender discrimination. Although further research is needed in order to identify the relative importance of each of these factors, Angel-Urdinola (2008) finds evidence that as much as 82.6 per cent of the gender pay gap in the country is not explained by any observable or objective factor. This indicates that widespread discrimination against female workers probably plays a major role.

Figure 4.8 presents the distribution of logged hourly wages of women and men. It again reveals how the distribution of women's wages is skewed towards lower wage levels. However, the gender

⁷ The average net monthly wage for women was MKD 9,305 and for men MKD 12,816, based on wage data for all sectors in 2006 and all employees, regardless of their economic status (paid, unpaid, full-time and part-time).

wage gap appears to be different in the public compared to the private sector. While women and men earn almost the same wages in the public sector, the gender gap is more marked in the private sector. We must again point out that women might be clustered in lower paying jobs, or that women working in the private sector have fewer qualifications and less work experience than men. However, the difference might also be explained by the existence of a “glass ceiling” with regard to women’s advancement, which cannot be checked by the available data.

FIGURE 4.8 | WAGE DISTRIBUTION FOR WOMEN AND MEN IN THE PRIVATE AND NON-PRIVATE SECTORS, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2007



Note: Data cover only employed persons with employee status.

Source: Author's own calculations based on LFS (2007).

Table 4.3 also illustrates how age is another determining factor, with wages varying across age groups and gender. In particular, while the average hourly wage for male workers and for all workers increases gradually, the wage increase for women between 55 and 64 is fairly steep. Hence, the wage ratio between 55 to 64 year-olds and 15 to 24 year-olds is 1.21 for all workers, 1.15 for men and 1.33 for women. This might imply that young women have fewer opportunities upon entering the labour market, while their relative labour market position improves with the age. This might be due to discrimination in the recruitment and promotion of women of child-bearing age.

Nationally, the average hourly wage of workers with a university education is 1.8 times higher than the average wage of workers with primary education or less (Table 4.3). Here again, the difference is greater for females where the ratio of university-educated workers' wages to those with primary education is at 2.3. From both an individual and a societal viewpoint, these findings imply that an important individual strategy for reducing probable segregation and gender discrimination would consist in encouraging women to obtain a better education.

The authorities could also undertake measures to prevent or at least mitigate wage discrimination. Indeed, the ILO reports that the former Yugoslav Republic of Macedonia has not properly implemented the Equal Remuneration Convention, 1951 (No. 100), which requires equal pay for work of equal value and thus the elimination of any potential for gender and other forms of pay discrimination.

Finally, gender pay discrimination can be reduced by proper implementation of the national Law on Equal Opportunities for Women and Men, which aims to remove gender stereotypes and prejudices, promote more equal education and give a boost to career options for women (such as encouraging the enrolment of girls in technical schools) and foster female participation in decision-making. However, as the European Commission stated (EC, 2009), there has been only limited progress in the implementation of the law and insufficient administrative capacity to implement it fully.

3.3 | Massive underdeclared (envelope) wages

Social partners who have been interviewed agree that envelope wages are present in all sectors and all types of workplaces, including successful enterprises, where additional payments are made through freelance contracts and/or into non-resident accounts abroad. However the extent of envelope wages is unknown. There is also a recognition that a lack of clear regulation of bonuses and other forms of payment creates room for an envelope wage system to develop. The Organization of Employers believes that further improvement in the business environment (especially the development of the rule of law) and increasing the number of effective state controls would considerably reduce instances of tax evasion and other forms of legislative non-compliance

Data on wages from 2008 provide evidence that official wages in various sectors are "bunched" around 65 per cent of the branch average wage, which corresponds to the minimum base for payment of social contributions (Table 4.4), a threshold which employers try not to exceed officially.

TABLE 4.4 | PROPORTION OF EMPLOYEES RECEIVING 65 PER CENT OF THE AVERAGE BRANCH WAGE, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2008

2008	Average wage	65% of AW	Wage brackets	% of workers receiving 65% of AW
Total	16,096	10,462	10,001–12,000	12.5
Agriculture	11,929	7,754	7,001–8,000	21.2
Fisheries	9,466	6,153	6,001–7,000	6.8
Mining	17,842	11,597	10,001–12,000	8.9
Manufacturing	12,613	8,198	8,001–9,000	7.3
Utilities	20,741	13,482	12,001–14,000	5.5
Construction	11,867	7,714	7,001–8,000	8.7
Trade	14,788	9,612	9,001–10,000	7.5
Hotels and restaurants	12,830	8,340	8,001–9,000	33.9
Transport and communication	19,568	12,719	12,001–14,000	11.0
Financial intermediation	30,651	19,923	18,001–20,000	9.9
Real estate, renting and business activities	16,086	10,456	10,001–12,000	18.1
Public administration	19,385	12,600	12,001–14,000	10.5
Education	15,381	9,998	9,001–10,000	2.5
Health and social work	15,185	9,870	9,001–10,000	9.4
Other services	14,392	9,355	9,001–10,000	6.0

Source: Author's own calculations based on wage data from SSO for year 2008.

Roughly 12.5 per cent of all workers in October 2008 received wages close to 65 per cent of the branch average wage. However, in some sectors the share of employees at this threshold is relatively high, particularly in hotels and restaurants, agriculture and real estate, which might imply that employers pay additional “wage” to their workers in cash. The gap between labour and capital income taxation might also lead to tax arbitrage through the transformation of an employee's labour income into capital income. For instance, a manager might work under a contract indicating a falsely low wage while receiving another portion in dividends.

The reduction of the minimum contribution base and of the ‘minimum average wage’ to be applied at the employer level (both from 65 per cent to 50 per cent of the branch average wage) as well as the establishment of a maximum cap on contributions (four average gross wages) instituted in January 2009 are expected to reduce firms’ incentives to pay envelope wages. The administration of tax and social contributions has also been improved, which should reduce the scope for tax evasion.

4 | Wage-fixing mechanisms

Wage setting is generally a decentralized process, as wages in the public sector and in large private firms are mainly determined through collective bargaining, while wages in small and micro-firms are generally unilaterally fixed by the management at the enterprise level. A distinctive feature is that before 2009 wage negotiations were based on net rather than gross wages.

Among the key elements is the Law on the Payment of Wages which regulates both the public and the private sector. In addition, the public sector wage-setting mechanism differentiates between civil servants and non-civil public sector employees.⁸ Finally, in January 2009 the gross wage reform was introduced, and a minimum wage regulation in the country also started to be considered.

4.1 | The Law on the Payment of Wages

In the first years of transition, particularly from 1990 to 1994, wage policy was determined according to the country's main macroeconomic challenge which was to fight extremely high inflation. Wage policy's key function was to curtail wage growth to avoid any wage-inflation spiral. This was implemented in 1992, through the Law on the Payment of Wages and Other Compensation and Dividends. With this legislation, the Government tried to keep wage and pension growth below inflation. This resulted in a real wage decline, as documented in Section 2.1. After 1994, the law was renamed as the 'Law on the Payment of Wages (LPW)'.

Following that period, changes were made to the LPW in two areas: (i) in the form of a maximum possible wage increase (as a percentage of the consumer price index); and (ii) in the scope of the legislation. Most recently, the LPW allows wage increases up to 50 per cent of the projected monthly inflation rate. With regards to the scope of the law, in 1994 it was narrowed to cover firms with less than 70 per cent private ownership. Meanwhile, in 1997 limitations were again imposed on all firms except those in full private ownership. And in 2002 the scope of the law was further narrowed to firms with less than 51 per cent private ownership (Official Gazette, No. 26/2002).

Currently, only one article of the LPW applies to the whole economy, including the private sector. It has been amended from its original form and currently requires the gross wage per worker paid by the employer not to be below 50 per cent of the average gross wage in the branch where the employer operates.⁹ The Ministry of Labour and Social Policy (MoLSP) has an obligation to announce the average gross wage in all branches by the twenty-fifth of the month.

This amendment, however, applies to the "average worker" in a company, not to each individual worker. There can thus be several workers in the company paid below that threshold. Moreover, employers can informally employ low-skilled workers. Trade unions such as the Association of Trade Unions supported the amendment as a wage protection measure for workers but added that it should be in the form of the minimum wage at either the branch level or the national level. In Section 6, the argument is made that the LPW should be abolished altogether.

⁸ According to the Civil Servants Act, a civil servant is a person who performs professional, normative-legal, executive or administrative-supervisory activities in the bodies of the state administration and in the expert services of the following: the Assembly of the Republic of Macedonia, the President of the Republic of Macedonia, the Government of the Republic of Macedonia, the Constitutional Court of the Republic of Macedonia, the Supreme Court of the Republic of Macedonia, the courts, the Judicial Council of the Republic, the Ombudsman, the Public Prosecution, the Civil Servants Agency and the State Audit Office, as well as in the bodies of units of local self-government and of the City of Skopje. A person employed in the aforementioned bodies/institutions that perform administrative-technical or support tasks does not have the status of civil servant and is subject to the general labour regulations. On the other hand, uniformed staff at the Ministry of Internal Affairs, military and civilian army personnel, employees of penal-correctional and education-correctional institutions, and of the Customs Administration etc. are part of the non-civil public administration.

⁹ Previously, the 'minimum average wage' at employer level was defined only for payment of contributions.

4.2 | Public sector wage setting

The main distinction in terms of wage setting in the public sector is between civil servants and non-civil public sector employees. Civil servants make up only 10 per cent of the entire public administration. Non-civil servants work primarily in education (about 35 per cent), health (25 per cent), internal affairs (15 per cent), defence (10 per cent), and social protection (7 per cent).

4.2.1 | Civil servants

Wage regulations

Wages of civil servants are regulated by the Law on Civil Servants (LCS) which was adopted in 2000 but has undergone several amendments, including the latest one passed in 2009 (Official Gazette, No. 114/2009). They aim to ensure greater professionalization of civil servants by changing the scope of the existing law, improving the vertical movement of civil servants and determining career wage supplements.¹⁰

However, the scope of the LCS is still narrow. For instance, the tax and customs administration, the Ministry of the Interior, the Ministry of Defence among other agencies are exempt from the new amendments. Other regulations (either laws or employer-level collective agreements) apply to these government functions due to their special duties and obligations. Thus, there are large differences in payment systems and wages among civil servants.

LCS classifies civil servants in three groups, based on their duties – managerial staff members, qualified staff members and qualified administrative staff members – and furthermore defines 13 job positions within these groups. The civil servants' wages are determined by the number of points they accumulate, which depends on such factors as job position and complexity, time in service, education and the current value of wage points– the latter is set annually by the government or the municipality no later than 15 days after the law on the execution of the budget is enacted.

Wage structure

The salary of a civil servant consists of the following components:

- basic salary, position supplements and career wage supplements;
- a so-called exceptional component, comprising of demanding job supplements and irregular supplements (for overtime work).

The basic salary depends on the educational level required for the job that is assigned to the civil servants –based on the by-law on the systematization of jobs– as well as on their work experience. The position supplement should reward each position relative to the nature and scope of the work, its complexity and the responsibility required from the civil servant. Work experience is valued at 0.5 per cent of the basic salary and position supplement (the sum of the points for the two) for each year of work experience, up to a maximum of 20 per cent. So far, however, work experience has been calculated only on the basis of the points for education.

¹⁰ Career wage supplement is an addition to the wage that depends on the length of service and is conditioned on positive assessment of civil servants' performance..

The aim of the career supplement is to reward professionalism and loyalty and thus provide an incentive for successful and professional performance, professional development and continuity in the civil service. A civil servant can receive the supplement upon fulfilling certain requirements related to length of service and performance assessment.¹¹ Depending on their current career development stage (there are four stages in total), a civil servant can receive a career supplement of between 5 and 20 per cent of the position supplement on the recommendation of their immediate superior.

Civil servants are entitled to a “demanding job” supplement for night work, shift work, high risk work and work done on weekly rest days and public holidays. In addition, civil servants also receive a supplement for overtime work in the amount of 35 per cent of the basic wage and a position supplement per hour, which can be compensated with additional leave. Table 4.5 presents a sample calculation of a civil servant's wage.

TABLE 4.5 | EXAMPLE OF A CIVIL SERVANT'S WAGE, (ADVISER WITH A UNIVERSITY EDUCATION, 7 YEARS' SERVICE, 10 HOURS' OVERTIME AND 8 HOURS' WORK CONDUCTED DURING A PUBLIC HOLIDAY, IN MKD DENARS), THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2010

	Number of points	Value of a point	Amount in MKD denars
Education	200	75.3	15,060.0
Work experience	200*3.5%	75.3	527.1
Basic wage			15,587.1
Job position supplement	281	75.3	21,159.3
Basic gross wage			36,746.4
Overtime	(36746.4/176*135%*10)		2,818.6
Work during public holiday	(36746.4/176*150%*8)		2,505.4
Total gross wage			42,070.5
	Rates (% from total gross wage)	Amount	Amount in MKD denars
Pension and disability insurance	19%		7,993.4
Health insurance	8.0% (7.5% + 0.5%)		3,365.6
Unemployment insurance	1.4%		589.0
Personal tax exemption		7 000	
Tax base for PIT			23,122.4
PIT	10% (of the PIT tax base)		2,312.2
Net wage			27,810.2

Source: Author's own calculation.

¹¹ Civil servants are assessed each year by their immediate superior (from the managerial staff) based on professional knowledge and skills at work, effort, results achieved, creativity and conscientiousness when performing tasks. The grades of the civil servant may be “outstanding”, “satisfactory” or “unsatisfactory”.

The LCS also determines additional compensation for civil servants such as sick leave compensation and compensation for business trips. Civil servants receive regular wages while on annual leave or while obtaining a higher education or qualifications.

Difficult implementation of the law

Although the LCS was enacted in 2000, implementation of the wage chapter which harmonized wages across the Government was postponed until 2004 because of large wage differences among the various public sector institutions and the budgetary implications. The wage chapter (i.e. the basic salary and position supplement components of civil servants' wages) was implemented from 1 April 2004 to 31 March 2006. It was referred to as a decompression process. The full implementation of the wage chapter, including the career supplement, was postponed several times for budgetary reasons, but was implemented in 2008.

Towards greater top-down disparity or lower compression

With this reform, the compression ratio – the ratio between the highest and the lowest wage in the civil service – rose from 3.3 in 2004 to 4.3 in 2006 (although, if the top 25 administrative jobs are excluded, the compression ratio declined to 3.1). The compression ratio is comparable to the average in the region, but considerably low relative to the EU15 (Verhoeven et al., 2007). Around 90 per cent of civil servants received wage increases within the framework of under such decompression. Wages of non-civil servants in the education and defence sectors also significantly increased in the process.

Wage moderation

Public workers in general (including civil servants but also non-civil public sector employees) did not receive an across-the-board wage increase between 2002 and 2007. The LPW was amended in 2007 to provide a gradual, three-year increase in public employees' wages by 10 per cent per year in October 2007, 2008 and 2009. In a period of frozen wages, this increase should preserve and even increase real wages (annual inflation in 2008 was 8.3 per cent). However, due to the ongoing national and global economic crises, the Government postponed the planned wage increase in October 2009 for a year. This measure was expected to help to maintain current employment levels while dampening aggregate demand.

Besides irregular and politically motivated wage increases, the wage of a civil servant can rise due to accumulated time in service, promotion and, since 2008, the career supplement, all of which increase a civil servant's wage points. Nonetheless, the Government should consider a "regular" indexation formula.

Unfortunately, the adequacy of public wages cannot be assessed because of a lack of data on the topic. Verhoeven et al. (2007) found anecdotal evidence that difficulties exist in the recruitment and retention of qualified staff in senior and managerial positions and for jobs requiring specialized and scarce skills (mainly in information technology and accounting). Although there is no comprehensive data on applications and turnover to assess such skills problems, a pilot study implemented in 2006 by the Hay Group on public and private sector pay in education, health and child protection showed that the highest difference in pay among employees holding the same position within different sectors can be found in managerial positions. Wages for higher positions in the private sector are rather based on

efforts to reward knowledge, skills, expertise, responsibility and accountability, which is not the case in the public sector.

4.2.2 | Non-civil servants

The law complemented by a general collective agreement

The mechanism for wage setting and negotiations for non-civil servants in the public administration is established through the LPW, collective agreements and area-specific laws.

The LPW provides general rules for public sector wage policy in terms of wage growth, while procedures for wage setting and negotiations are established and implemented through the General Collective Agreement (GCA) for the public sector, and in branch and employer collective agreements. There are certain sectors, such as the army, where wage setting is defined in the law. Employer-level collective agreements are usually signed for public enterprises but are not readily available.

The public sector GCA is signed between the Government and a representative trade union. It lasts two years, and will be automatically extended if the parties do not call for new negotiations. At the request of one of the parties, it can be re-negotiated within the two-year period. For changes that should be implemented in the meantime, parties may sign an additional agreement within GCA that becomes effective when signed and made public. Such a situation might arise, for instance, when a new minimum wage is negotiated.

Wage structure

Non-civil servants' wages consist of a basic salary plus performance-related supplements. The basic wage is based on complexity factors set for each job position which are multiplied by the lowest wage in the branch. Complexity factors and the lowest wage for the least complex job position (hereafter: the lowest wage) are set in the branch or through employer-level collective agreements. The GCA does not determine the complexity factors, but it does establish the rule for the calculation of the basic wage (the multiplication formula). According to the GCA (from June, 2009), the basic wage increases 0.5 per cent for each year in service, up to 20 per cent. Performance-related wage additions are paid solely when government institutions have sufficient budget resources. Wage supplements for non-civil public sector employees prescribed by the GCA are similar to those provided to civil servants.

Branch collective agreements (for education, culture, social protection, health, police and so on) define specific complexity factors and determine the lowest wage for the least complex job. They can be published annually, quarterly or ad hoc, and possibly based on politically-motivated factors, for instance pre-elections generosity.

Public administration employees in Interior and Defence ministries, as well as the Public Revenue Office and the Customs Administration, are entitled to specific supplements which substantially raise their wages above their peers within the Government. These supplements range from 20 per cent for fire fighters) to 50 per cent for employees with significant responsibilities in the Public Revenue Office.

Wage disparity between different state institutions

The compression ratio¹² for the basic wage in public administration ranges from 2.6 in primary and secondary education to four in the army and police departments and 8.30 in the health sector. However, there are higher wage supplements in certain sectors – for example, the army and the police – where the actual compression ratio is higher. In this regard, specific wage supplements expand the wage gap for workers with comparable jobs in different state institutions.

All branch-level agreements were “re-negotiated” at the end of 2008 and early 2009 to reflect the new gross wage system, which in practice changed the complexity coefficients. Amendments were applied to salaries in January 2009. Since then, there has been another “re-negotiation” of the lowest wage in the education, culture and child protection sectors in order to implement the 2008 agreement between the Government and the unions. This agreement, following a strike, prescribed an increase in food allowances in these sectors. The agreement was then implemented as an increase in the minimum wage¹³ for the least complex job position, as well as a slight change in the complexity factors in order to keep wage increases constant in all job positions (and at all wage levels) (see Table 4.6).

TABLE 4.6 CALCULATION OF THE WAGE OF A HEAD TEACHER IN PRIMARY EDUCATION WITH 10 YEARS' WORK EXPERIENCE AND 20 HOURS' OVERTIME, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2009				
		Supplements	Calculated as:	Amount in MKD denars
1	Complexity coefficient		2.6	
2	Lowest wage* (i.e. value of coefficient)			11 867.0
3	Wage 1		$r1*r2$	30 272.7
4	Work experience (5% * Wage 1)	5% (10 years* 0.5%)	$5\%*r3$	1 513.6
5	Wage 2		$r3+r4$	31 786.4
6	Supplement for class head	$0.135 * \text{lowest wage}$	$0.135*r2$	1 602.0
7	Overtime work (20 hours)	$(\text{Wage 2} / 176 * 135\%)$	$r5/176*20*135\%$	4 876.3
8	Total gross wage		$r5+r6+r7$	38 264.7
		Rates (% from total gross wage)	Calculated as:	Amount in MKD denars
9	Pension and disability insurance	19%	$19\%*r8$	7 270.3
10	Health insurance	8% (7.5% + 0.5%)	$8\%*r8$	3 061.2
11	Insurance in case of unemployment	1.40%	$1.4\%*r8$	535.7
12	Personal tax exemption			7 000.0
13	Monthly tax base		$r8-r9-r10-r11-r12$	20 397.5
14	PIT	10%	$10\%*r13$	2 039.8
15	Net wage			25 357.8

Note: r stands for row; 176 hours is the number of working hours in a month.

Source: Author's own calculations.

12 Ratio between the highest and lowest complexity factors or the highest and lowest number of points, depending on the wage system.

13 In the meantime the food allowance was abolished.

In some branch collective agreements in the public administration (including those for governmental and legal institutions) a provision allows the employer in certain circumstances to pay up to 20 per cent in lower wages to employees for up to six months. However, the employer must subsequently compensate workers for the unpaid amount.

4.3 | Wage fixing in the private sector

Besides the Labour Code, the general framework for wage negotiation in the private sector is determined by the private sector GCA, and by the signed branch collective agreements (which currently number about 15). The most recent private sector GCA was signed in July 2009 between the Association of Trade Unions and the Organization of Employers. According to the GCA, private sector wages consist of a basic wage, a performance-related wage and wage supplements.

The basic wage is determined similarly to in the public sector, by multiplying wage coefficients by the lowest wage. The GCA outlines nine complexity levels ranging from coefficients of 1.00 to 3.00. This structure is fairly compressed, but branch collective agreements can prescribe higher coefficients. The lowest wage is also set at the branch level, and according to the GCA it should be re-negotiated at least once a year. The GCA requires that the lowest wage be indexed with the average annual inflation, and applied starting from January of the following year. The GCA creates the possibility that an employer can pay a lower basic wage (at most 20 per cent lower than the regular wage) in cases of liquidity or due to operational problems experienced by the firm, for up to six months. Thereafter, or as soon as the problems cease, the employer must pay workers the total amount of accumulated wage arrears.

The GCA requires that employers establish transparent criteria for performance-related pay. Workers are entitled to wage supplements for demanding working conditions, such as environmentally non-friendly conditions. These supplements should not be related to workers' wages – in other words, they should be equal across all wage levels and positions. The GCA determines additional supplements for night work, shift work, overtime work and work undertaken on weekly rest days and public holidays.

Private sector workers receive a 0.5 per cent supplement on top of the basic wage for each year of service, which cannot exceed 20 per cent of the basic wage. In the most recent GCA for the private sector (2009), a provision was added that employers who do not organize meals and transportation for their workers can increase their workers' basic salary, as a mere possibility.

The GCA provides similar wage compensation to the public sector for sick leave, business trips, annual leave and leave taken in order to obtain a higher education or qualifications. The difference is that compensation in the private sector is related to the individual worker's wage in the previous 12 months rather than the national average wage.

Given the relatively large informal economy and the prevalence of micro and small firms in the former Yugoslav Republic of Macedonia, employers appear less likely to face wage policy constraint compared to other countries in the EU15. Unfortunately, there are no data on union density and bargaining coverage in the former Yugoslav Republic of Macedonia to confirm this trend. Given the weakness of collective bargaining in the country it seems that regulation would provide more effective protection to workers than the collective agreement. In fact, trade unions also believe that the minimum wage should be established by law instead of through collective agreements.

4.4 | Taxes and social security contributions

In 2009, a reform was implemented in the area of labour taxation (in PIT and social contributions) which led to a reduction in labour costs. While tax reductions were implemented worldwide as part of various stimulus packages, the tax reform was planned and designed before the crisis had affected the national economy. Whereas the rationale for such reform in a period of crisis is to stimulate aggregate demand in response to lost fiscal revenues, the aims of the national wage reforms country were to reduce the tax wedge, simplify tax collection and reduce tax evasion.

This section explores and assesses the success of the wage reform. Wages were formerly taxed by PIT and social security contributions, both of which were paid by the employer on behalf of employees. The overall social contribution rate was 32 per cent of the gross wage, of which 21.2 per cent was for pension and disability insurance, 9.2 per cent for health insurance and 1.6 per cent for unemployment insurance. There were some differences in the bases for social contributions, which complicated wage calculations. Social insurance contributions were (and still are) fully deductible from the personal income tax base. Recently, the PIT system was changed (see section 2.1) and now the country has one of the lowest personal income tax rates in the world.

Despite the fact that the labour tax rates were based on the gross wage, wage negotiation and contracting in the country were based on a net wage system that was used in the former Yugoslavia. Hence, the system of calculation of labour taxes was fairly complex and required a grossing-up procedure,¹⁴ as presented in Table 4.7.

¹⁴ Meaning that wage calculation was starting from net wages, which had to be “grossed” because social contributions’ and personal income tax rates are set as a per cent of gross wage.

**TABLE 4.7 | NET AND GROSS APPROACHES TO CALCULATING WORKERS' WAGES,
THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA**

Calculation starting from net wage		Calculation starting from gross wage	
<i>Calculation of personal income tax (PIT)</i>		<i>Calculation of social insurance contributions (SIC)</i>	
	Denar		Denar
1. Net monthly salary*	16,096	1. Gross salary	25,762
2. Personal PIT exemption	3,294	2. SIC	8,244
3. Next taxable salary	14,224	(2) = (1) x 0.32	
(3) = (1) – (2)		of which:	
4. Personal income tax (PIT)	1,422	for pensions	5,462
(4) = (3) x (0.1) / (0.9)		= (1) x 0.212	
5. Gross salary 2 (before SIC)	17,518	for health insurance	2,370
(5) = (1) + (4)		= (1) x 0.092	
Calculation of SIC		for unemployment insurance	412
5. Gross salary 2	17,518	= (1) x 0.016	
6. Gross salary 1 (before SIC)	25,762	3. Personal PIT exemption	3,294
(6) = (5) x [1 / (1–0.32)]		4. Tax base for PIT	14,224
7. Total SIC		(4) = (1) – (2) – (3)	
(7) = (6) – (5)		5. PIT	1,422
of which:		(5) = (4) x 0.1	
for pensions	5,462	6. Net wage	16,096
= (6) x 0.212		(6) = (1) – (2) – (5)	
for health insurance	2,370	7. Total tax on labor	9,666
= (6) x 0.092		(7) = (2) + (5)	
for unemployment insurance	412	as % of gross wage	37,5%
= (6) x 0.016		= (7) / (1)	
8. Total taxes on labour (PIT + SIC)	9,666		
(8) = (4) + (7)			
as % of gross wage	37.5%		
= (8) / (6)			

Note: * This is the average net wage in 2008.

Source: Author's own calculations.

In the absence of a statutory minimum wage and given the guaranteed minimum pension, there was a regulated minimum wage floor for the payment of social contributions, which was 65 per cent of the average net wage in the economy, regardless of the worker's actual wage. The tax burden on low-skilled labour was therefore relatively high, which led to greater unemployment and informality for low-wage workers. While the labour tax wedge for a worker who earned the average wage and received tax-free fringe benefits (food and travel allowances) was around 33 per cent, the labour tax wedge for a worker who earned 50 per cent of the average wage was as high as 39 per cent and indicative of the regressive nature of the system. Overall, the tax wedge was high compared to neighbouring countries (see WB, 2008 for details), although it declined slightly after the PIT rate was first reduced.

Labour costs were also high because firms would usually give their workers tax-free allowances in cash for hot meals and transport between home and the workplace. If they remained below the maximum prescribed amount, these allowances remained untaxed. The regressiveness of the system was somewhat mitigated by the allowances (which were the same across all wage levels), and by the general personal income tax exemption.

The wage reform implemented in January 2009 consisted of the following:

- full harmonization of assessment bases for social contributions;

- reduction of social contribution rates from 32 per cent in 2008 to 27.9 per cent in 2009, and further to 22 per cent in 2011;
- reduction of the minimum floor for the payment of contributions, from 65 per cent to 50 per cent of the average gross wage in the economy;
- introduction of a gross wage concept of wage negotiation and contracting, the incorporation of tax-free allowances into wages and the transfer of liability for the payment of social contributions from employers to workers;
- integrated collection of PIT and social insurance contributions by the Public Revenue Office.

To implement the reform, a new Law on Mandatory Social Insurance Contributions was passed which defined liabilities for the payment of social contributions that were previously defined separately and somewhat inconsistently. Changes were also made to the Labour Code (Official Gazette, No. 161/2008) and the redefinition of some of the statutory rights, such as pension indexation, that were tied to the (net) average wage was implemented. Some collective agreements were also re-negotiated.

The full potential of the 2009 reform was undermined by the global economic crisis. However, the relatively good performance of the labour market in 2009 (see Section 5), may have been related to that reform.

According to data from the SSO, the average monthly net wage in January 2009 increased from December 2008 by 13 per cent, which can be viewed as the effect of incorporating food and travel allowances into the basic wage. The average gross wage increased by less (4.5 per cent) which indicates that employers' costs declined due to reduced social contribution rates and higher personal tax exemptions. Contrary to the expectations of trade unions that the reform would hurt low-paid workers since employers would not incorporate food and travel allowances into the wage, the published data demonstrated that average wages in the lowest-paid sectors increased in line with the national average. For example, the average net wage in the textile industry increased by more than the national average – namely by 17.6 per cent between December 2008 and January 2009 (with a gross wage increase of 4.8 per cent) and by 20 per cent in the leather industry (with a 11.6 per cent gross wage increase). In addition, wage arrears declined to 2.6 per cent of all employees in January 2009 from 7.5 per cent in December 2008.

Nevertheless, Annex 2 illustrates the trade unions' claim that the reform led to a deterioration of working conditions. Employers' organizations generally supported the reform, because it addressed the soft budget constraints facing unsuccessful firms through stricter and simpler collection mechanisms. They also acknowledge that the reform reduced the tax wedge, especially for low wage workers, which should improve their relative position in the labour market, and eased the administrative burden. However, they are still proposing a number of improvements (see Annex 2).

Despite the reduced social contribution rates, data from the Public Revenue Office show that the revenue collected in 2009 was seven per cent higher than in 2008. The revenues of the Pension and Disability Insurance Fund increased by ten per cent and the Agency for Employment's revenues increased by three per cent, whereas the revenues of the Health Fund declined slightly.¹⁵ Tax evasion is thus likely to have declined as well.

¹⁵ A possible explanation for reduced health insurance revenues in light of the rise in other social contributions is that, prior to the reform, the evasion of health insurance payments was lower since they related to a direct service, in contrast to pension and employment insurance, whose benefits are to be realised only in the future.

4.5 | The lack of minimum wage regulation

According to Saget (2008), minimum wage regulations affect wage flexibility as well as overall labour market flexibility. Thus, national policy in this area is extremely important.

As already indicated, the former Yugoslav Republic of Macedonia has no statutory nationwide minimum wage. Instead, there is a statutory minimum floor for the social contribution payments which offers only a future safety net for workers in terms of pensions and ensure some minimum contribution to social funds. In addition, the Law on Payment of Wages requires that the average wage at the employer level cannot be lower than 50 per cent of the average gross wage in the branch. This is expected to protect workers' living standards although to a limited extent (see Section 3.3). As UNDP (2006) argues, such a system "seems to help neither firms nor workers and does lead to inefficiencies" (UNDP 2006, p. 60).

While there is no statutory minimum wage in the private sector, it can be established through a branch collective agreement, as implemented in the leather and textile sectors. Minimum wages in these two branches have been set slightly below 50 per cent of the average net wage in their respective branch. However, given that provisions of collective agreements are applicable only to parties to the agreement, minimum wages and wage grids are not necessarily binding on all companies in the branch.

The minimum wage in the public sector is established through an agreement between the parties that signed the branch collective agreement. These agreements are somewhat confusing since they set the lowest wage for the least complex job position, but also a minimum wage for the branch. As a result, workers with a complexity factor of 1 and those with a factor of 1.2 found themselves receiving the same wage – that is, the minimum wage – despite differences in complexity and the types of jobs they perform. Instead of establishing both the lowest and the minimum wages, it would be an option for the social partners to negotiate only a minimum wage in order that pay progression would be more suitable and equitable with regard to workers' duties.

Minimum net pay for the public sector was set in 2006 at a rate of MKD 5,040 per month, which was 37 per cent of the average net wage in the economy. The minimum wage rate was raised by 10 per cent in 2007 and 2008, along with the general increase in wages in the public administration. There are no provisions for the automatic adjustment of minimum wages in response to price developments as these are negotiated and published in an agreement between the signatory parties. Minimum wages in some branches of the public sector (primary and secondary education, culture and child protection) increased again in July 2009 (applying to the June wage), in line with the increased lowest wage (see section 4).

Establishment of a statutory minimum wage has been on the agenda of the Economic and Social Council several times and is very much to the fore in public debates. However, the social partners have different views on the matter. Trade unions support setting a statutory nationwide minimum wage, while employers' organizations hold the view that minimum wages should be set in branch and/or employer-level collective agreements. However, the Economic and Social Council has not met since May 2008 and hence there was no progress in this area.

The country has ratified the Minimum Wage Fixing Convention, 1970 (No. 131), initially as part of the former Yugoslavia. Although the national authorities have provided the ILO with information on wage determination mechanisms in the country, including minimum wage fixing, the ILO required additional

information on the method used to determine minimum wages despite the absence of a statutory national minimum wage.

The arguments for and against the introduction of a minimum wage have been debated and have taken into account the specific national labour market context.

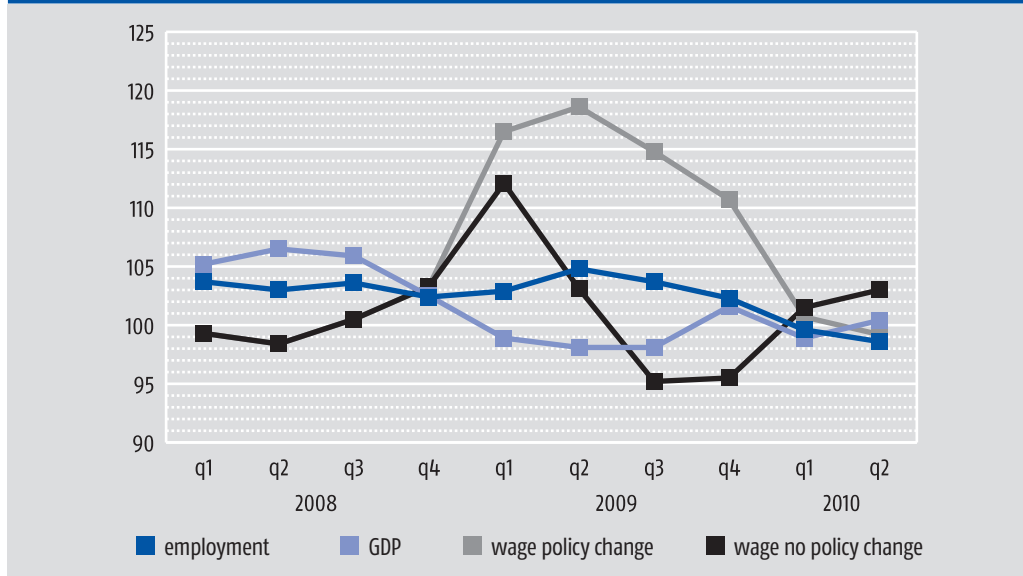
Minimum wages have a positive role since they act as a wage floor that can prevent wage depression and large declines in aggregate demand. As such, they can be considered an automatic stabilizer and are also associated with reductions in poverty levels, wage inequalities and low pay (ILO, 2009a and b). They can also be important for productivity and were not found – especially where they are adjusted in a regular and gradual way – to have negative effects on employment (Vaughan-Whitehead 2010). This is also the reason why over recent years there has been a renewed interest in the minimum wage (Vaughan-Whitehead, 2010; ILO, 2009b). On the other hand, Rutkowski (2008) argued that a country facing high unemployment and informal employment such as the former Yugoslav Republic of Macedonia should not rush to set up a statutory minimum wage. Given high youth unemployment and high informal employment in the country, a high minimum wage might, for instance, set up barriers to the creation of entry-level firms (UNDP, 2006). Based on the same type of arguments, although initially set at an “appropriate” level, the minimum wage can also be expected to easily increase in pre-election periods or for other politically-motivated reasons, and thereby eventually encourage informal employment and job destruction for already vulnerable categories of workers.

There are thus arguments both for and against the establishment of a nationwide statutory minimum wage. However, it is certain that the country would benefit from more concise and rational minimum wage regulations and negotiations, without “indirect” minimum floors either for average wages (as required by the Law on Payment of Wages) or for social contributions (as set by the Law on Mandatory Social Insurance Contributions).

5 | The economic crisis and policy responses

This section explains some of the recent economic developments in the country from 2008 to the first half of 2010, and then explores national policy responses.

The relatively high GDP growth experienced in 2007 continued through 2008, but was considerably reduced in the last quarter of the year, when the global economic crisis began to affect the national economy (see Figure 4.9). Although the country did not suffer directly from the global financial crisis, the impact was felt indirectly through trade, investments and remittances. Relative to its neighbouring countries, as well as the EU-27 countries, the GDP decline in 2008 and 2009 was relatively modest.

FIGURE 4.9 | QUARTERLY GDP, EMPLOYMENT AND REAL GROSS WAGE INDEXES, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2008–2010 (1ST SEMESTER)

Source: Authors' calculations based on LFS data, national accounts and employment and wages surveys, different years.

The data show that reduced domestic production affected labour market performance with a time lag. LFS data for 2009 show that employment (for persons over 15) continued to grow at a relatively rapid pace in 2009 – by 3.4 per cent compared to 2008. The employment rate increased by 1.1 percentage points, although it remained at a low level of 38.4 per cent (43.3 per cent for the age group 15–64). Simultaneously, the unemployment rate in 2009 declined by 1.6 percentage points to 32.2 per cent. These positive trends were spread evenly among all categories of workers, including vulnerable ones. However, in the first half of 2010, a downward adjustment in the labour market was observed when employment fell by 0.9 per cent compared to the first half of 2009. At the same time, the number of unemployed persons increased by 1.2 per cent. Data from the Employment Agency show a slight increase in the number of registered unemployed at the beginning of 2009 and 2010 (Figure 4.10). In the course of the recession, the incidence of wage arrears increased even if at a lower rate than its pre-reform levels.

FIGURE 4.10 | REGISTERED UNEMPLOYMENT AND WAGE ARREARS DURING THE RECESSION, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

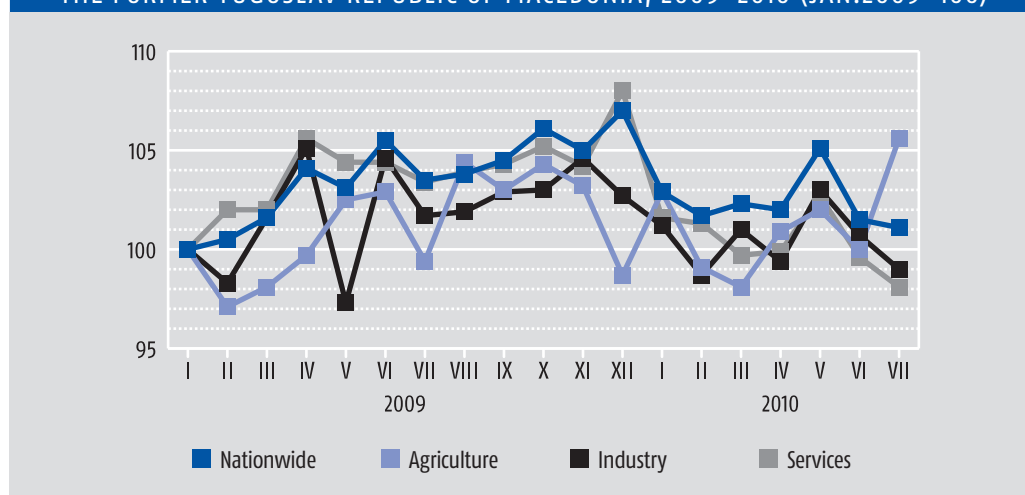
Source: Author's calculations based on data from Employment Agency and SSO, different years.

Despite a high annual average inflation rate of 8.3 per cent in 2008, the average real gross and net wages increased by 0.4 per cent and 2 per cent, respectively, which probably suggests that wages adjusted quickly to inflation.

The 2009 reform in the area of payroll taxes, which included a reduction of social contribution rates and the integration of previously untaxed allowances into the wage, led to a high methodological increase of wages in January 2009 (presented by the line indicating policy change in Figure 4.9). In particular, gross and net wages increased in 2009 by 15 per cent and 25 per cent respectively in real terms.

The higher growth of the net wage compared to the gross wage was due to the inclusion of food and travel allowances in the net wage and the reduction of social security contribution rates. While there was no policy change in 2009, both real gross and net wages increased by 12 per cent in the first quarter of 2009 in comparison to the same quarter in 2008. In 2010, annual real gross wage growth entered into a negative zone as a result of labour market adjustments, the additional reduction of social security contribution rates as of January 2010 and the high inflation rate. Nevertheless, the growth of the real gross wage adjusted to the policy changes shows an upward trend from the fourth quarter of 2009 through the first semester 2010 (Figure 4.9).

FIGURE 4.11 | REAL GROSS WAGE INDEX, THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA, 2009–2010 (JAN.2009=100)



Source: Author's calculations based on SSO data, various years.

Figure 4.11 shows that, despite some monthly variations, there was an upward trend in the real gross wage in 2009, with the exception of agriculture.¹⁶ The reduction – that is, fluctuation – of wages in industry can be related to the decision of a few companies to reduce the wages of their workers by 20 per cent (see Section 4.3.). The increase of the national average wage might also be the result of methodological deficiencies, since if insolvent and/or low productivity companies do not pay wages in a given month, it would increase the average wage in the branch and in the economy.

Policy responses

The Government has announced or implemented four stimulus packages to support economic activity, with the last one starting a year ago. In the area of wage policy, the following measures have been implemented:

- a wage freeze in the public sector, as explained in Section 4.2;

- the reduction of social security contributions (although this measure, along with the broader wage reform, cannot be regarded as a policy response since preparations started in early 2008);
- an increase in the minimum wage in some public sector branch collective agreements;
- the establishment of a Fund for agricultural land, which will give land to eligible unemployed individuals (registered unemployed from rural areas), and announced with the fourth anti-crisis package.

The absence of more substantive wage policy responses to the crisis can be explained by the already planned and implemented wage reform, the positive performance of the labour market and the lack of awareness among policymakers of the need for, and potential positive effects of, additional policy measures.

Unfortunately, collective bargaining has not been effective during the recession because of disagreements related to representativeness of the employers' and employees' organisations which has inhibited one of the most important mechanisms for reaching all-party consensus in response to the crisis. Instead, an intensified dialogue has ensued among Government and employers on the economic outlook and available policy options. However, the experiences of other countries have shown that tripartite institutions (and not mere consultations) have been most efficient in finding responses to the crisis (ILO, 2009); and that centralized negotiations with comprehensive agendas work much better and are more successful in protecting vulnerable groups, which are rarely organized.

In some enterprises, there was "concession bargaining" between workers and management, but these centred mainly around "defensive" strategies, such as reducing labour costs through wage cuts in order to preserve jobs in the short run. However, enterprises could have reaped long-term benefits by applying proactive strategies aimed at enhancing productivity through improvements in the production process, work organization and innovation.

6 | Conclusions and policy issues

This chapter offers a detailed analysis of wage developments and of national wage fixing mechanisms from 1990 to 2010, and the most recent trends and policy responses to the recession. Throughout the analysis, several areas for improvement are identified.

Improving the awareness of policymakers of the relative importance of wage policy as a policy tool in a period of recession (as in a period of expansion) is key. In this regard, public discussion and debate on wage policy should be encouraged.

Similarly, social dialogue should be strengthened both at the bipartite level – branch and enterprise level – and the tripartite level – through the Economic and Social Council. The advantage of the latter, especially in a period of recession is that it ensures a more comprehensive negotiating agenda and can provide protection to vulnerable unorganized groups of workers (including those on atypical work contracts). On the other hand, bipartite negotiations can be conducted in a shorter time period and take into account the specificities of the branch or enterprise. It is important, however, that they are based on proactive strategies that bring long-term benefits for both parties and society instead of mere short-term reductions in labour costs.

Enhanced social dialogue may contribute to further clarify the wage-setting mechanism, which was found to be ineffective and produce rather poor outcomes. Although most collective agreements provide some indexation enterprises and workers should also consider strengthening the link between wages and productivity.

Transparency of the wage negotiation process would be increased by greater availability of data on wages and information on collective agreements. Problems do arise when some signatory parties fail to submit collective agreements to the Ministry of Labour and Social Policy on time as required by law, so that the Ministry cannot provide such information. There is also an obligation of the Ministry – that is not always kept – to maintain a database of enterprise-level collective agreements and make it accessible.

Furthermore, the Law on the Payment of Wages should be gradually abolished because the major reason for its initial introduction – to prevent a wage–inflation spiral – is no longer relevant. Moreover, we have presented evidence that the law does not in fact protect workers (including those in the private sector) and that other mechanisms for avoiding a decrease in wages and ensuring a wage floor, such as a branch or nationwide minimum wages, could be more effective..

This chapter offers arguments for and against the introduction of a statutory minimum wage, which should be further explored and discussed within the national tripartite body. As the ILO argues, mechanisms for determining minimum wages should be clarified and made more effective, for instance by gradually abolishing the “indirect” minimum average wage floors. A debate on the introduction of a national minimum wage should be engaged.

From the perspective of gender equality, the Government could also undertake various measures to reduce the gender pay gap. National legislation should be amended to allow for a proper implementation of the principle of equal remuneration for work of equal value.

Improvements are also necessary to establish a more effective wage system in public administration. The scope of the Civil Servants Act should be extended while allowing some additional room for the specific features of certain institutions, positions and job duties. In addition, a more general framework for wage determination in the overall public sector is needed but it has not been set up by the Government despite continuous and urgent calls from the Ministry of Labour and Social Policy. The Government should consider introducing a regular adjustment mechanism for wages of public sector employees that would be adjusted annually in relation to CPI/GDP. This could reduce the room for political manoeuvre and increase the predictability of wage developments.

In order to attract and retain well-qualified managerial staff, the Government should also consider – after a more comprehensive analysis of the public wage system – further decompressing the wage scale. In addition, the system of rewarding work experience should be changed from rewarding the worker's overall experience to rewarding his or her experience within the public administration. The differentiation between civil servants' wages should likewise be based on their performance and not only on their length of service.

Many steps are thus needed to make wage policies more effective in the former Yugoslav Republic of Macedonia.

The above policy implications should be discussed and assessed between the social partners to establish a more structured wage setting mechanism that would benefit workers and employers, as well as society as a whole.

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Annex 1 | Sources and methodological explanations of wage indicators

There are two main sources of data on wages: the establishment survey Labour 1, on employees and wages, and the Labour Force Survey (LFS). The establishment survey collects data on both gross and net wages, with a clear definition and distinction between the two. However, it is the author's opinion that there are some methodological problems with the data (see below). The State Statistical Office does not recommend using wage data from the LFS for several reasons, such as the differing perceptions of respondents concerning the definition of wages (for instance, employees and those working informally report a net wage, whereas self-employed persons report a gross wage), and the difficulty in distinguishing between a wage and additional monetary compensation, in the form of food and travel allowances, wage supplements and so on.

Regarding the frequency of data, establishment data are collected monthly and annually. The monthly news releases of the SSO contain data solely for national and sectoral (in total, 15 sectors) average wages that are net or gross. It does not provide data on average wages by gender, age, education, occupation and so on. Here, methodological problems arise given that the calculations account only for collected (responded to) wage questionnaires. In addition, only paid wages are considered, which deceptively increases the average wage in months when a firm does not pay wages to its employees, especially since wage arrears are more common for firms that pay lower wages. It also reduces the average wage in months when these companies pay their workers the previous wage in addition to the current wage that was not paid on time.

The annual publication *Employees and Net Wages* contains data on net wages, national and by sector, as well as data on the lowest and highest actual wages by sector and the ratio between the two. This source of data does not break down information by gender, age, education or other worker characteristics. It does provide weighted average wages, and takes non-responses into account.

The establishment survey (both monthly and annual) is based on a representative sample of all firms in various forms of ownership and for all employees, excluding individual farmers, self-employed professionals and workers with civil-law contracts. It covers about 70 per cent of employees in each branch from the National Classification of Activities. According to this survey, the **net wage** consists of total net payments made to employees (including for overtime), annual leave allowance, compensation for holidays determined by law, paid leave up to seven days, compensation for paid leave for obtaining a higher education or qualifications, and sick leave up to 21 days. The data are collected in absolute figures and reported as indexes. Nominal indexes are then adjusted with the Consumer Price Index (CPI) to calculate and report real growth rates.

The **gross wage** is defined as the net wage augmented by personal income tax and mandatory social contributions.

Given that food and travel allowances were not considered part of either the net wage or the gross wage until 2009, labour costs were higher than the gross wage. There were certain low-productivity sectors in the economy (for example, in the textiles and leather industry) where the two allowances were as high as the net wage, because they were untaxed up to a certain level. This situation changed in 2009, when food and travel allowances were incorporated into the net wage.

In this chapter, data from the enterprise survey are used only in the more general analysis (for instance, for wage developments, unit labour costs and so on) and for the sectoral wage distribution. More detailed exploration of wage trends and wage distribution is based on the LFS data on wages but is restricted to employees, excluding employers and self-employed to avoid problems related to the net and gross wage division. The data source is listed under each table or figure.

Annex 2 | Views of the social partners on the main wage policy issues

The author conducted an interview with representatives from two employee organisations: the Confederation of Free Trade Unions and the Association of Trade Unions of Macedonia, as well as from two employers' organisations: the Organisation of Employers of Macedonia and the Confederation of Employers of Macedonia.

The views of the Confederation of Free Trade Unions, which represents mainly public administration workers, were as follows:

Minimum wage – This should be regulated at national level on a statutory basis.

Collective agreements and negotiations – There was a need for renegotiation of the GCA for the public sector which "expired" in January 2009. Negotiations were supposed to start in October 2008, after the amendments to the Labour Code had been passed. The MoLSP was supposed to register and keep not only general and branch collective agreements, but also employer-level agreements. This was intended to introduce transparency into the wage system. Although branch collective agreements were revised to implement changes in the legislation related to the introduction of a gross wage system, and all wage supplements were revised downwards and expressed as a percentage of gross wages, this was not the case for the supplement for work experience (0.5 per cent of the basic wage).

Gross wage reform – Reform was in general positive, but it is not properly implemented everywhere; for example, there are irregularities in some public enterprises regarding the treatment of food and travel allowances.

Envelope wages – This is not an issue in the public administration.

Association of Trade Unions of Macedonia:

Minimum wage – This should be regulated at national level on a statutory basis. They would also accept the minimum wage being established and regulated at national level through general collective agreements, although this might be problematic because it would then not apply to parties which are not signatories. Besides the national statutory minimum wage, they also support the negotiation and establishment of a minimum wage at branch level through branch collective agreements which cannot set a minimum wage lower than those set by law and/or in the GCA.

Collective agreements and negotiations – Collective agreements should be more precise in order to avoid varying interpretations. The MoLSP should not just register collective agreements but also control their content. There is also a need to control the implementation of agreements. In general, the capacity

of the MoLSP in the area of social dialogue and collective agreements should be improved. Both general courts and economic courts argue that collective agreements are not under their jurisdiction. The Union supports the view that branch collective agreements should define the wage system with regard to each job position in more detail and thus avoid discretionary decisions.

They express concern that there are no collective agreements for some branches for various reasons, such as the lack of trade unions and/or employers' organisations, or no interest in collective negotiations.

Gross wage reform – The trade union reports a deterioration in working conditions (for instance, provision of cold meals to workers instead of cooked meals, as previously), reduced take-home pay in low-paid sectors (partial incorporation of food and travel allowances into wages) and so on.

Envelope wages – These exist where there is no regulation or the regulation is not very clear and/or precise. This applies to bonuses which are not regulated (and hence are prohibited) in the Labour Code. They can be prescribed in branch or employer-level collective agreements, but if such do not exist, bonuses can be paid as envelope wages.

Organisation of Employers of Macedonia

Minimum wage – This should be established either through branch collective agreements or at enterprise level in order to take account of the economic current circumstances of the branch/employer. Otherwise, job creation, especially at low wage levels, might be harmed and the position of labour market entrants worsened.

Collective agreements and negotiations – In general, they regard collective bargaining as effective. In this regard, they do not express concern that minimum wages are not decided in most branches by mutual agreement between the social partners, after negotiations.

Gross wage reform – They take the view that the reform was successful and that, besides easing the administrative burden, it reduced labour costs and hence opened up some space for employers to increase workers' (net) wages as a motivational factor.

Envelope wages – There are cases of the payment of envelope wages but there is no information on how widespread it is. They believe that further improvements in the business environment (especially the rule of law), along with effective state controls, would considerably reduce the incentive and possibility for tax evasion and other forms of non-compliance with the legislation.

Confederation of Employers of Macedonia

Minimum wage – This should be negotiated at branch and/or enterprise level instead of at national level because the former better represents the current financial and more general conditions in the branch/enterprise. They also support the establishment of clear mechanisms for minimum wage determination.

Collective agreements and negotiations – This employers' organisation is not a member of the Economic and Social Council. They welcome the amendments to the Labour Code (in terms of parliamentary procedure) that set clear and better representativeness criteria and believe that they will meet the criteria and hence become a social partner with a negotiating mandate. For the time being, they have reached an informal agreement with the Association of Trade Unions of Macedonia and the Union of Independent Trade Unions of Macedonia in seven branches.

Gross wage reform – They have a positive general assessment of the reform since it creates a level playing field for all companies, instead of the previous implicit state subsidization of failing firms. However, they argue that the current ex-ante control of payment orders from the Public Revenue Office should be transformed into ex-post, risk-based control in order to reduce administration for firms, as well as build trust relations between enterprises and state institutions.

Envelope wages – There are some unregulated areas that allow room for the payment of envelope wages. Envelope wages exist in both low-paid sectors and in (mainly multinational) large successful enterprises where additional payments are made through freelance contracts and/or into non-resident accounts abroad. With regard to the latter, they support the profit retention tax paid by foreign companies transferring (part of) their profits abroad.

The Impact of the Crisis on Wages in selected Balkan Countries

5 Behind the veil of statistics: Bringing to light structural weaknesses in Serbia

MIHAIL ARANDARENKO AND SONJA AVLIJAŠ

1 | Introduction

The purpose of this chapter is to analyse wage trends and policies before and after the financial and economic crisis in Serbia, as well as specific wage-related policy responses to the crisis.

The pre-crisis period (2000–08) in Serbia witnessed rapid average wage growth and more moderate growth in the labour share – the latter because of diminishing formal employment. Wage growth in general cannot be singled out as a major source of growing imbalances and deficits, as often claimed by policymakers and some experts. However, since public sector wages drove overall wage growth the public sector share of the total wage bill also grew rapidly. This was a consequence of both more rapid public sector wage increases compared to wages in the rest of the economy and the public sector's expanding share in overall formal employment.

Wage growth recorded by the Serbian Statistical Office was faster than “true” wage growth, for two reasons: (i) the inclusion of fringe benefits in the taxable wage base in 2001 which led to a one-off surge

in gross wage levels; and (ii) the bias of the RAD¹ enterprise survey which is the main source of wage statistics and where the public sector and large private firms are overrepresented.

At the same time, high minimum mandatory social security contributions have particularly hit low-paid workers, since their gross wages are disproportionately higher than their take-home earnings. This was especially the case until 2004 with the base for minimum social security contributions set at 40 per cent of the average wage and even additionally adjusted by education levels. More generally, effectively regressive labour taxation contributed to lower living standards for low-wage workers (incidence of working poor, crowding out into the informal economy). Since regressive taxation led to formal employment attrition, it contributed to the reduction of the formal labour share and promoted duality and informality in the labour market. Labour reforms from 2006 onwards removed some of the abovementioned disincentives but there is still a lot of scope for improving the progressivity and fairness of labour taxation.

Social dialogue and collective bargaining as an instrument of wage policy has been marginalized, except in the public sector. The minimum wage has not been excessive, and its enforcement weak, to the extent that average wages in some low-paid sectors are below the minimum wage. While the minimum wage followed the average wage, the subsistence minimum was steadily declining, down to as little as 15 per cent of the average wage in 2008, because it was adjusted exclusively to the Consumer Price Index (CPI).

The gender pay gap in Serbia has been of a similar magnitude to what is found in other European countries, with female wages lower than male wages by 15–16 per cent when controlling for education and other relevant conditions, according to a couple of snapshot studies based on Labour Force Survey data. Although Serbia has incorporated adequate anti-discrimination legislation, the enforcement is inconsistent in its application.

Surprisingly, average wage growth has continued since the crisis, albeit at a slower pace. Adjustment to falling GDP took the form of nominal wage freezes in the public sector, with some nominal cuts in above-average wages in public administration. At the same time private sector wages were mostly adjusted through employment reduction, especially among second-tier workers.

Overall, a fairly rapid employment decline has occurred in the economy since the start of the crisis, with those in vulnerable employment hit quite hard, although it is still difficult to assess the full extent of it. Labour share increased initially, but more recently it has started to decline again to pre-crisis levels. A significant minimum wage increase in January 2009 helped to preserve the labour share in the first half of 2009, but its consequent freeze contributed to the later fall in the labour share.

Social dialogue has become less important after years of negotiations with the conclusion of the General Collective Agreement (CGA) in spring 2008, followed by the latter's suspension throughout the crisis without any branch collective agreements signed outside the public sector. In more recent developments, the trade unions have agreed to cut employment in central administration by some 10 per cent.

The chapter consists of seven sections. The next section gives an account of macroeconomic, labour force and wage trends in the period prior to the crisis (2000–08) and section three focuses on Serbian wage policy during the 2000s, including labour taxation and minimum wage policy. Sections 4 and 5 analyse the post-crisis period, including changes in employment and wage trends, while section 6 looks at wage-related policy responses. Section 7 presents policy conclusions and recommendations.

1 “RAD” means labour in Serbian.

2 | Wage dynamics before the crisis (2000–2008)

2.1 | The macroeconomic context

Serbia started its market reforms much later than other transition economies due to the international economic sanctions which lasted throughout the 1990s. Since the democratic changes which took place in the second half of 2000, the country has managed to improve its macroeconomic stability and maintain high and steady economic growth until the start of the 2008 recession. The country began recovering slowly at the start of the following year (see Table 5.1).

TABLE 5.1 | SELECTED MACROECONOMIC INDICATORS, SERBIA, 2002–2007

	Annual data					
	2002	2003	2004	2005	2006	2007
Prices and the exchange rate	y-o-y					
Consumer price index, y-o-y	14.8	7.8	13.7	17.7	6.6	10.1
Nominal fx dinar/euro (€) (period average)	60.7	65.1	72.6	82.9	84.2	80.0
Economic growth	annual real growth					
GDP (in billions of dinars)	973	1,126	1,381	1,684	1,961	2,302
GDP (in millions of euros)	16,028	17,306	19,026	20,306	23,305	28,785
GDP, growth y-o-y	3.9	2.4	8.3	5.6	5.2	6.9
Fiscal data	in % of GDP					
RS budget deficit/surplus, in % of GDP	-4.3	-2.6	-0.3	0.3	-1.9	-1.7
Overall fiscal balance (GFS definition) ^{1) 2)}	.	.	17.5	14.8	-33.5	-58.2
Public Revenues	39.9	40.3	41.2	42.1	42.4	42.1
Public Expenditures	43.0	41.4	40.0	39.7	42.7	42.8
Foreign trade	in millions of euros (€) flows					
Imports of goods	-6,399	-7,220	-9,500	-9,613	-11,971	-15,578
Growth rate y-o-y	27.6	12.8	32.4	0.7	24.5	30.1
Exports of goods	3,123	3,856	4,458	5,330	6,949	8,686
Growth rate y-o-y	16.0	23.1	16.3	19.1	30.4	25.0
Current account balance	-1,314	-1,251	-2,278	-1,804	-3,137	-4,615
in % GDP	-4.2	-7.8	-13.8	-8.8	-10.1	-16.0
Foreign direct investments	502	1,206	773	1,248	4,348	1,942
RS public debt (external+internal), % of GDP	71.9	63.7	50.9	50.6	40.1	31.4
NBS foreign exchange reserves	2,186	2,840	3,117	4,935	9,025	9,641

Notes: In the first quarter of 2008, NBS changed the Balance of Payments methodology. Due to this change, there is a drop in current account deficit, and a decrease in the capital account balance.

1) NBS estimate.

2) The overall fiscal result (fiscal balance according to GFS 2001) – Consolidated surplus/deficit adjusted for “budgetary lending” (lending minus repayment according to the old GFS).

Source: National Bank of Serbia (NBS), Foundation for Advancement of Economics (FREN), 2002–09.

Between 2001 and 2008, GDP was growing at an average rate of about 5.4 per cent per year, with the highest growth – 8.3 per cent – achieved in 2004. Strong GDP growth in Serbia since 2001 is due to the development of the service sector, particularly in its financial and commercial segments which have been growing at double-digit rates while industrial and agricultural sectors expanded at a much slower rate.

The living standards of the majority of the population improved significantly since 2001. GDP per capita increased from about 1,700 euros in 2001 to 4,190 euros in 2008. The incidence of poverty halved, from approximately one million people or 14 per cent of the population in 2002 to 490,000 or 6.6 per cent of the population in 2007 (Living Standards Measurement Study: Serbia 2002–07, 2007).

Inflation was reduced from about 41 per cent in 2001 to about 8 per cent in 2003 and, after the lowest rate was registered in 2006 (around 6.6 per cent), it rose two-digits again in 2007 (10.1 per cent). In 2009, inflation was down to 6.6 per cent and it fell even further in the first half of 2010. A restrictive monetary policy in response to the economic crisis has contributed to this recent relative price stability in Serbia.

Serbia experienced rapid expansion of foreign trade since the start of the transition and its exports increased by almost 30 per cent per year between 2005 and 2007. However, the volume of exports was insufficient to reduce the trade deficit which amounted to 17.8 per cent of GDP in 2008. Serbia has been facing a large negative trade balance because of the weak export-orientation of its companies. On the other side, credit growth during the 2000s was driven by household lending which grew by more than 51 per cent in 2007 alone and translated into higher domestic demand accompanied by stronger import growth.

Fiscal policy was largely expansionary between 2000 and 2008. Consolidated general government spending reached 44.9 per cent of GDP in 2007, up from 42 per cent in 2005 and spurred by increases in both capital and current spending. In the last quarter of 2008, consolidated general government spending dropped by 3.5 per cent year-on-year, due to the pressures for budgetary contraction triggered by the financial crisis. However, it remained well over 40 per cent of GDP throughout 2009 and 2010 with a budget deficit of around 4.5 per cent of GDP in both years.

High growth of foreign direct investment (FDI) in Serbia since 2000 is the consequence of privatization and the sale of existing resources, rather than a more sustainable trend of greenfield FDI. Serbia received 3.5 billion euros in outside investment in 2006, while in 2007 and 2008 FDI amounted to around 1.8 billion euros per year until 2009 when it fell to 1.3 billion.

2.2 | Labour force movements

High unemployment and slow generation of new jobs constituted a major socio-economic problem throughout Serbia's transition period. The rise in unemployment during the 2000s was the product of privatization and the necessary restructuring of overstaffed and inefficient state-owned and socially-owned companies. At the same time the economy failed to generate enough private sector jobs to compensate for these losses in employment and absorb new entrants into the labour market.

A positive turn in the trends of falling employment and growing unemployment was achieved in 2007, together with the peak in the rate of economic growth. Unfortunately, this general improvement

of labour force indicators arose from the expansion of vulnerable employment in agriculture and self-employment (mainly in the informal economy). In other words, as people lost their jobs in the formal economy they gradually replaced them with “last resort” forms of employment and often self-employment. Once enough people had made this transition, the unemployment rate started to drop, although this job generation did not spring from the dynamic growth and recovery of the economy, but rather from household coping strategies. In fact, in the formal sector efficiency gains were mostly achieved through employment cuts. For this reason, the number of employees in the formal sector continued to drop, even as unemployment started to decrease after 2007 (see Table 5.3). Meanwhile, the Labour Force Survey (LFS), which covers both the formal and the informal sector, showed increases in the total number of employees and consequent decreases in the number of unemployed (see Table 5.2).

Table 5.2.a and 5.2.b, based on LFS data, demonstrates that a positive turnaround in both employment and unemployment trends was reached in 2007, if only temporarily, due to the negative impact of the economic crisis on the labour market in 2009 and 2010. Although the drop in unemployment between 2007 and 2008 was partially influenced by certain methodological changes to the LFS, unemployment in Serbia continued to decrease albeit temporarily in 2007 before climbing upward by 5.4 percentage points between October 2008 and April 2010 as a consequence of the ongoing economic crisis.

The female employment rate has been significantly lower in averaging between 20 and 14 percentage points below the male employment rate during the observed period (with a falling trend over time). Female and male unemployment rate dispersion varied between nine and three percentage points in the same period, with a tendency to narrow over time. Much of this change in the relationship between male and female labour market indicators since 2004 can be attributed to the change in LFS methodology in 2008, which resulted in an improved coverage of traditional female activity (such as unpaid household work) in the employment category.

TABLE 5.2.a | EMPLOYMENT, LABOUR FORCE SURVEY, SERBIA, 2004–2010¹⁾

		Number of employed 15–64 ²⁾			Number of employed in agriculture and unpaid family workers 15+ ³⁾			Employment rate 15–64		
		Total	Female	Male	Total	Female	Male	Total	Female	Male
2004	October	2,735,977	1,141,187	1,594,789	641,720	280,391	361,328	53.4	44.0	63.1
2005	October	2,574,139	1,033,151	1,540,988	586,708	245,288	341,419	51.0	40.8	61.2
2006	October	2,516,794	1,029,085	1,487,709	501,937	198,356	303,581	49.9	40.6	59.2
2007	October	2,525,570	1,064,011	1,461,559	521,420	207,419	314,001	51.5	43.0	60.0
2008	April	2,652,429	1,150,004	1,502,425	670,141	314,259	355,882	54.0	46.0	62.3
2008	October	2,646,222	1,122,835	1,523,387	589,240	266,728	322,512	53.3	44.7	62.2
2009	April	2,486,734	1,081,108	1,405,626	580,066	260,458	319,608	50.8	43.3	58.7
2009	October	2,450,643	1,058,767	1,391,875	537,231	233,597	303,634	50.0	42.7	57.4
2010	April	2,278,504	977,548	1,300,957	439,973	193,860	246,113	47.2	40.3	54.3

TABLE 5.2.b | UNEMPLOYMENT, LABOUR FORCE SURVEY, SERBIA, 2004–2010¹⁾

		Total number of unemployed 15–64			Unemployment rate 15–64		
		Total	Female	Male	Total	Female	Male
2004	October	664,002	361,511	302,491	19.5	24.1	15.9
2005	October	718,773	390,097	328,676	21.8	27.4	17.6
2006	October	691,877	352,788	339,089	21.6	25.5	18.6
2007	October	584,216	295,234	288,982	18.8	21.7	16.5
2008	April	432,730	219,879	212,851	14.0	16.1	12.4
2008	October	457,205	235,468	221,737	14.7	17.3	12.7
2009	April	486,858	238,820	248,038	16.4	18.1	15.0
2009	October	516,990	250,562	266,427	17.4	19.1	16.1
2010	April	572,502	259,062	313,440	20.1	21.0	19.4

Notes:

1) LFS data are only comparable since 2004. Until 2008, LFS was conducted once per year – in October. Since April 2008, it is conducted semi-annually, in April and October.

2) Population aged 15–64 is considered working-age population.

3) LFS classification on those employed in agriculture and unpaid family workers for the 15–64 age contingent of the population disaggregated by sex is not published by the RS0.

Source: Labour Force Survey (LFS), Serbian Statistical Office (SSO).

On the other hand, no positive turnaround in employment trends is visible in the Serbian Statistical Office (SSO) administrative records (RAD survey, Table 2.3) throughout the period since these records only account for the formal sector. These findings confirm our proposition that most of the job generation observed in the LFS took place in the more informal and vulnerable parts of the economy, and is therefore not captured by the statistics.

Finally, the administrative records of the National Employment Service (NES) show a decline in unemployment rates in 2007 (see Table 5.3, column 7). This is partially due to the increased NES controls over eligibility criteria for social benefits, which cleared out from the administrative records a large portion of those registered as unemployed in order to obtain the benefits. The higher absolute number of women registered with the NES confirms the higher numbers of unemployed women than men recorded by the LFS.

TABLE 5.3 | REGISTERED EMPLOYED AND UNEMPLOYED,¹⁾ SERBIA, 2002–2010

				Self-owned businesses			
		Total no. of employed	Employees in legal entities	Total no. of self-owned businesses	No. of self-owned businesses	No. of employees in self-owned businesses	Total no. of employees
		1 (=2+3)	2	3 (=4+5)	4	5	6 (=2+5)
		in thousands					
2002	March	2,083	1,719	365	185	180	1,899
	September	2,042	1,657	386	189	197	1,853
2003	March	2,040	1,633	407	196	211	1,844
	September	2,030	1,605	426	199	226	1,831
2004	March	2,065	1,601	464	208	255	1,856
	September	2,037	1,560	477	210	267	1,827
2005	March	2,070	1,557	513	228	285	1,842
	September	2,067	1,536	531	230	300	1,836
2006	March	2,032	1,496	536	228	308	1,804
	September	2,019	1,447	572	242	330	1,777
2007	March	2,004	1,438	566	239	327	1,765
	September	2,001	1,428	573	245	328	1,756
2008	March	2,006	1,432	574	245	329	1,761
	September	1,993	1,425	568	245	323	1,748
2009	March	1,911	1,411	500	210	290	1,701
	September	1,868	1,383	485	211	274	1,657
2010	March	1,817	1,362	455	199	257	1,618

Notes:

1) By registered number of employed, we refer to the formal economy, i.e. those employees with employment contracts and for whom social security contributions are being paid. By the registered number of unemployed, we refer to those persons that have registered with the National Employment Service (NES). NES shifted from monitoring the number of job seekers to the number of unemployed persons in September 2004. This is why in column 7 we do not show data for the previous period.

Source: RAD survey, Serbian Statistical Office; National Employment Service (NES), 2002–2010.

2.3 | Wage trends

Due to the general collapse and frequent extreme shocks that hit the Serbian economy during the 1990s, the statistics on the average wage for the period between 1995 and 2000 are not reliable or relevant for this analysis. Thus, we will present only wage trends after the democratic change that took place in October 2000 and marked the start of the transition to a market economy in Serbia.

2.3.1 | Data sources

The main source for wage statistics in Serbia is the establishment survey (RAD) of the SSO. RAD is a monthly survey of employment and wage statistics, with more detailed research conducted semi-annually and used as a verification tool for the monthly surveys. However, the verification refers only to employment estimates, not to wage estimates. RAD is also the official source of wage statistics which represent the main input for a large number of public policy decisions, such as those involving the determination of

social assistance allowances, pensions and the minimum wage. One of the main shortcomings of the RAD survey is that it does not publish sex disaggregated data.

There are other survey based sources of wage data, such as the Labour Force Survey, the Household Budget Survey (HBS) and the Living Standards Measurement Survey (LSMS) that are carried out by the SSO but that are all less credible than the RAD survey. As household surveys, they are based primarily on personal subjective statements of people who tend to underreport their income for various reasons. Furthermore, in these surveys it is not possible to distinguish between wages paid out in the formal sector versus those obtained from informal activities. Finally, the samples in household surveys are too small to allow for reliable sector or regionally disaggregated data. However, one positive aspect of LFS as a wage data source is that it can convey significant information on the discrepancy in earnings between the genders. Nevertheless, survey data on wages have to become more reliable before this and other potential benefits can be fully exploited.

Finally, an alternative source of wage statistics is the tax authorities' data on wage tax revenues, from which the average wage for the formal economy can be calculated. However, they are not publicly available, and even if accessible, the data could only give indications of the average wage for the entire economy or a certain region. It is not possible to disaggregate between sectors and types of employment or gender. Therefore, tax data could only be used to check the reliability of the wage data collected through the RAD survey.²

To ensure regional comparability of wage trends we will focus on the gross wage. However, it has its own limitations for purposes of comparison: the gross wage is neither the amount which workers take home, nor the total labour cost, but instead the net wage plus wage tax³ plus the portion of social security contributions paid by the employee. Hence, the ratio of average gross wage to average net wage and to average labour costs per worker varies across countries.

2.3.2 | Wage growth overestimated in 2008

In this section we discuss general trends, but also warn of the sources of bias in official statistics that monitor the average wage.

Average wages have grown strongly since 2000 in Serbia and significantly surpassed GDP growth in all years but 2008. The annual real growth rate of the average wage was 13.5 per cent, in comparison to the average annual growth rate of GDP of 5.4 per cent in 2001–08 (see Table 5.4). The rate of nominal wage growth, although high, declined steadily throughout the observed period, while in some years substantial inflation rates “ate away” much of real wage growth.

² It was in fact the use of tax data that helped to uncover some methodological shortcomings of the wage statistics in the RAD survey, which will be discussed in the section on wage dynamics.

³ Personal Income Tax (PIT).

TABLE 5.4 | AVERAGE MONTHLY WAGE AND ANNUAL INDICES, SERBIA, 2000–2009

	Nominal wages				Annual (year on year) gross wage indices	
	Gross, in dinars	Net, in dinars	Gross, in euros	Net, in euros	Nominal	Real (CPI)
	1	2	3	4	5	6
2000	3,803.6	2,393.3	74.5	46.8
2001	8,711.9	5,393.5	146.4	90.7	229.0	117.5
2002	13,297.6	9,223.5	219.2	152.0	152.6	127.7
2003	16,638.2	11,517.5	256.1	177.3	125.1	113.9
2004	20,575.5	14,121.0	283.3	194.4	123.7	111.4
2005	25,565.3	17,477.7	308.3	210.8	124.3	107.0
2006	31,801.1	21,745.2	377.7	258.3	124.4	111.3
2007	38,781.2	27,785.4	484.9	347.4	121.9	114.6
2008	45,689.6	32,757.2	560.9	402.1	117.8	104.4
2009	49,710.3	35,639.8	528.3	378.8	108.8	100.6

Notes:

Dinar is the Serbian national currency.

Average wage for Serbia in 2009 is an estimate of the average wage in legal entities only, in order to make the wages comparable with the previous period, following which the methodology for estimating the average wage changed.

Source: RAD survey, Serbian Statistical Office (SSO), 2000–09.

A number of changes in labour tax regulations since 2000, as well as the biased nature of the sample of establishments used for wage monitoring in the statistical system, led to some distortions in recorded wage trends throughout the period 2000–09. Because of these distortions, both wage levels and their growth dynamics were overestimated to a certain extent throughout 2000–08. Still, after a careful analysis of existing data sources and their limitations, it remains clear that average wage growth was higher than GDP growth for the entire period, with the exception of 2008.

The years 2001 and 2002 recorded very large nominal wage growth both in order to catch up from the rock bottom levels reached during the 1990s, and to make up for price liberalization.⁴ However, this growth is also partially due to the reform of the labour taxation system: the taxable wage base was extended to include meals,⁵ holiday bonuses and travel reimbursement and there was a shift to gross wages as the basis for tax deductions. Reform of labour taxation was a viable attempt on behalf of the authorities to increase the fiscalization of the economy since, prior to this regulation, sizeable portions of wages were becoming tax exempt simply by being accounted for as fringe benefits. Therefore, this one-off increase in gross average wages through the inclusion of fringe benefits greatly influenced the hike in gross wage indices in both 2001 and 2002.

During 2003 and 2004, gross wages kept growing, but this was partially due to the elevated levels of social security contribution rates between June 2001 and May 2003.⁶ They amounted to 32.6 per cent of the gross wage which was evenly split between the employee and the employer. As of May 2003,

4 Price hikes due to sudden price liberalization were the reason why real wage growth was not as large.

5 "Food stamps" were distributed to all employees in equal amounts in cash.

6 Social security contributions are made up of contributions to pension insurance, health care insurance and unemployment insurance.

the contribution to pension insurance went up by 0.5 per cent for both employee and employer which resulted in increased total social security contributions by one percentage point. In September 2004, the social security contribution rates were raised again to a combined total of 35.8 per cent of the gross wage. However, the abolishment of the tax on the so-called "wage fund" – at 3.5 per cent and paid by the employer – compensated for most of these social security contribution rate increases. Therefore, this change had some impact on the dynamics of the gross wage growth rate, but was practically neutral with regard to total labour costs.

Wage growth in 2007 was influenced by the latest amendments to the personal income tax law whose implementation started in January 2007. Personal income tax (PIT) was reduced from 14 per cent to 12 per cent. The first 5,000 dinars of every wage became tax exempt while the social security contributions paid by the employee and the employer remained at the same level. This adjustment represented the first attempt to introduce progressivity into the Serbian labour tax system.

This 2006 amendment of tax regulations had the opposite impact on wage growth from the earlier taxation of fringe benefits and increases in social security contribution rates. While both the taxation of fringe benefits and the increases in social security contribution rates contributed to the faster growth of the gross wage than of the net wage, these more recent reductions in the tax burden encouraged a faster upsurge of net wages – assisted by the average wage bias of the union dominated public sector which was protecting the net wage.

The SSO's tendency to overestimate wage levels in the 2000s makes for an unreliable source on methodological grounds. Arandarenko and Stanic (2006) observe that the sample of companies in the RAD survey, which monitors wage trends in Serbia, has not been effectively revised since 2001. In the meantime, the RAD survey also systematically overestimated wage levels. As Stanic (2006) notes, wages have been predominantly observed as a subset of enterprises that do not properly reflect a Serbian economy dominated by enterprises in the public and socially-owned sectors which have been partly privatized over time. At the time there has been insufficient coverage of small and new private firms.

On the other hand, as Arandarenko and Vukojevic (2008) explain, there have also been significant job outflows from the companies represented in the RAD sample to those not represented in the sample. Due to restructuring, many of those who lost their jobs in the socially-owned companies resurfaced in other sectors of the labour market by taking new jobs or entering self-employment. These new forms of employment have not been included in the RAD survey. Finally, the wages earned by proprietors of self-owned businesses and their employees only started to be monitored at the beginning of 2009 when the RAD sample was expanded to include their activity.

Therefore, until 2009, two sources of bias in the data collection were observed which led to overestimation of the average wage: (i) the outdated sample of companies which excluded the newly established private firms and (ii) the complete absence of small business wages. Average wages in both segments of the economy have been significantly low compared to what is paid out by the public and socially owned sectors – the latter two represented the predominant group of enterprises monitored by the SSO.

An ad hoc research survey on wages in small businesses conducted by the SSO (Serbian Statistical Office, 2006) indicated that most of the wages paid out by small businesses were around 40 per cent of the average wage registered by the SSO which is close to the minimum wage. Although it is realistic to

assume that some small businesses pay out a portion of their employees' wages in cash, this chapter focuses on wage policy in Serbia and so we are mainly concerned with trends in the formal economy. Since the employees of small businesses represent almost 20 per cent of the total number of employees, it is realistic to assume an overestimate of average wages from this source of statistical bias of around 12 per cent. This hypothesis is further confirmed by the latest SSO data where due to the change in the sampling frame for average wage calculations, which as of 2009 includes small business employees, there was a decrease of around 12 per cent in the officially registered average wage in 2008. It is important to note that this change in the sampling frame caused another structural break within the average wage series, since the data for 2009 are now only comparable to the data for 2008. 2008 is the only year for which we have average wage data based on both the old and the expanded sample of wage earners. However, this shift represents a very significant improvement in monitoring the average wage in Serbia and it is therefore laudable.

Many decisions related to wage policy have been based on these overestimated wage data which has led to a number of policy consequences. As a 2006 World Bank report (World Bank, 2006) on the labour market in Serbia points out, the average wage data have been used to calculate pensions and other social benefits adjustments, along with the standard of living indices. They also serve as an important input for semi-annual tripartite minimum wage adjustments, and often represent a starting point for collective bargaining in the public sector and increasingly in large privatized companies. As the international competitiveness of the Serbian economy is largely related to labour costs, the overestimation of the average wage in Serbia could have significantly affected the country's standing in the eyes of foreign investors, particularly when coupled with an extended period during which the dinar, the domestic currency, was overvalued.

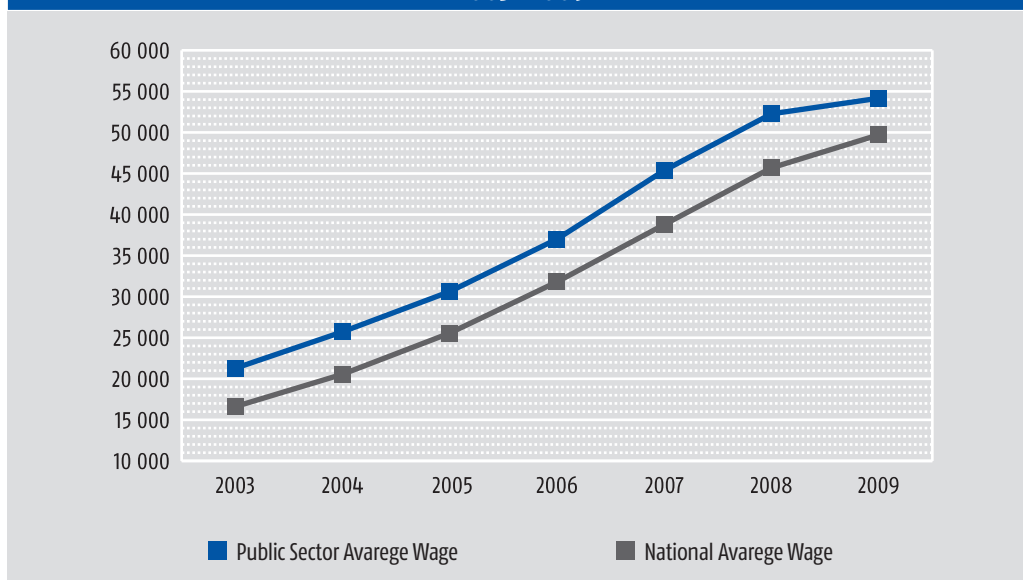
In conclusion, it appears that the growth of wages in the observed period in Serbia is a culmination of the formalization and fiscal adjustment of the economy. However both the growth dynamics and levels have been significantly overstated and resulted in a number of erroneous policy implications. Arandarenko and Vukojevic (2008) point out that Serbia is the best example of a situation in which the intensive transformation of the labour market, triggered by the far-reaching general economic policy changes in 2000 and privatization programme of 2001 has happened simultaneously with a national statistical office not ready to change its wage data collection methods. As a result, published establishment wage data were becoming increasingly unreliable and biased.

2.3.3 | Public sector wages growing at a much faster pace

During the period in question, wages in the public sector were growing at a much faster pace than those in the rest of the economy (see Figure 2.1). This was the intention of policymakers, who wished to help some sectors, such as education and health care, to catch up. Every year, one or more sectors was singled out for a substantial wage increase, well above inflation and wage increases in the rest of economy – including the state-owned and municipal public companies and their workers in administration, education and health care who receive their wages directly from the state budget. It is also important to emphasize that public sector wage data represent the lower bound of the average wage in that sector, since it is not clear from the methodology whether the statistics account for those portions of wages which are paid to workers in health care and education from the revenues of the institutional

employers.⁷ In addition, the difference between the average wage in the public sector and the national average wage shown in Figure 5.1 is underestimated to a certain extent, since the RAD survey skews the national average wage towards the public sector.

FIGURE 5.1 | PUBLIC SECTOR AVERAGE WAGE AND NATIONAL AVERAGE WAGE, SERBIA, 2003–2009



Source: Serbian Statistical Office.

Although nominally higher wage levels in the public sector in comparison to the entire economy can be justified on the grounds of their employees' higher levels of education their growth can still be assessed as excessive and fiscally reckless.

The first significant increase took place at the end of 2003 and the beginning of 2004, around the time of the parliamentary elections which took place in December 2003, as well as the presidential elections in mid-2004. In the same fashion, there was a large one-off increase in public sector wages in October 2006 immediately prior to the announcement of the next parliamentary elections. In 2007, there was a record growth in public sector wages with the largest wage rise – 23.8 per cent in real terms – in health care. Finally, 2008 saw additional significant public wage increases, due to the presidential elections which took place in January 2008, and were followed by a new round of parliamentary elections. Meanwhile, the local elections took place in May 2008. This policy of raising public sector wages at a much faster pace than GDP and the wages in the rest of the economy, while also above the economy average in nominal terms, was extremely irresponsible and has since become the source of many problems related to the current unsustainable of levels of government spending.

⁷ Public institutions which have their own sources of revenue (for example, tuition fees for the University of Belgrade) have the discretion to pay higher wages to their employees than those allocated to them from the state budget.

Keeping in mind the average wage bias towards the public sector, we can see the vicious circle in which the high growth of public sector wages influenced the recorded average wage, against which many other public expenditures are indexed, including pensions and social assistance. This in turn pressured wage growth in the private sector which generated excess domestic demand, price increases and reduced Serbia's international competitiveness.

2.3.4 | Labour share

The labour share shows how much of national income accrues to labour. For the purpose of this analysis, we calculated the labour share as the ratio of total labour costs – wages and salaries before taxes, as well as employers' social contributions – to GDP. Moreover, since the SSO wage did not include the wages which small businesses pay to their employees until 2008, and an ad hoc SSO research study on small businesses (Small Businesses in Serbia, 2006) showed that they normally pay the minimum wage (around 40 per cent of the average wage), we multiplied the number of employees of small businesses by 40 per cent of the average wage for each year, in order to estimate their wage bill. To add incomes generated from self-employment, we attributed two-thirds of mixed incomes to labour and one-third to capital – a standard commonly applied in industrialized countries – and calculated their labour share as two-thirds of the average wage in the economy.⁸ However, there is an important caveat in these estimates: the personal income of farmers is not accounted for since the RAD survey does not cover them, although their production is included in the national accounts and amounts to around eleven per cent. Although further adjustments might be needed for regional comparisons, our estimates are still reliable enough to show the direction of the labour share over time in Serbia.

Table 5.5 shows that the labour share has been growing in Serbia since 2002, albeit from a low level. From 2007, it started more or less to level off. According to Luebker (2007), the labour share typically varies between 40 and 60 per cent of GDP, and is generally higher in industrialized than in developing countries. It averages just over 50 per cent of GDP in the OECD countries and Asia, around 40 per cent in Latin America, the Middle East and North Africa, and around 30 per cent in sub-Saharan Africa.

TABLE 5.5 | WAGE BILL AND LABOUR SHARE, SERBIA, 2002–2009

	Wage bill	Labour share
2002	348,364,366	35.7
2003	426,747,052	38.8
2004	525,197,870	39.7
2005	652,310,317	40.3
2006	789,994,364	41.5
2007	943,898,421	43.6
2008	1,110,974,053	43.1
2009	1,162,606,891	43.3

Source: Serbian Statistical Office and author's calculations.

8 According to Labour Force Survey trends, around 67 per cent of all employed persons are wage employees, but this figure includes the informal sector. Almost 90 per cent (between 87 and 89 per cent) of those covered by the RAD survey are paid workers.

3 | Wage policies before the crisis

3.1 | Labour taxation

In Section 2.3.2, we described how changes in labour taxation policy throughout the 2000s affected wage trends. Other important features of the reform also exacerbated the surge in gross wage levels recorded by RAD and are important in helping us understand the limitations of analysing only gross wages.

The flat universal wage tax of 14 per cent and the consequent regressivity of labour taxation rates until 2007 increased the below-average gross wages at a faster pace than their take-home net counterparts. This effect has been further strengthened by the minimum mandatory social security contribution base which was set at 40 per cent of the average wage⁹ – reduced to 35 per cent in 2007). This implies that the actual base for social security contributions can be higher than the social security contributions implied by take-home wages and as such is increasing the gross wages of low-paid workers without affecting their net wages.

The integration of fringe benefits into gross wages resulted in the crowding out of low-paid workers from formal employment (and thus from the RAD sample) through the following mechanisms:

- labour intensive sectors lost their competitive advantage and shed labour at a faster pace (for example, textiles, and metals);
- the informalization of previously formal low-paid jobs, thus reducing the weights of sectors, regions and firms dominated by low-wage labour in the RAD sample;
- regressive taxation facilitated investment in capital intensive and high wage sectors, such as finance and banking, thus perhaps bringing more high-paid jobs into the RAD sample.

A summary of the changes in the rules on personal income tax and social security contributions that affected the dynamics of the average gross wage is given in Table 5.6.

9 It was also differentiated by education levels until 2004.

TABLE 5.6 | LEGISLATION ON PERSONAL INCOME TAXATION AND SOCIAL SECURITY CONTRIBUTIONS, SERBIA, 2001–2007 (%)

	From June 2001 until 1 May 2003	From 1 May 2003 until 1 September 2004	From 1 September 2004 until January 2007	From January 2007
Personal income tax	14	14	14	12
Tax exemption, in dinars ¹⁾	n.a.	n.a.	n.a.	5 000
Tax on wage fund, valid until July 2004	3.50	3.50	n.a.	n.a.
Employee-based contributions:	16.30	16.80	17.90	17.90
Pension and disability insurance	9.80	10.30	11	11.00
Health insurance	5.95	5.95	6.15	6.15
Unemployment insurance	0.55	0.55	0.75	0.75
Employer-based contributions:	16.30	16.80	17.90	17.90
Pension and disability insurance	9.80	10.30	11	11.00
Health insurance	5.95	5.95	6.15	6.15
Unemployment insurance	0.55	0.55	0.75	0.75
Total percentage of tax and social security contributions in gross wage	59.90	61.40	60.80	58.80

Note:

1) Exemption refers to the gross wage.

Source: Arandarenko and Nojkovic, 2007.

3.2 | Basic protection through the minimum wage and social assistance

3.2.1 | From a minimum wage fixed unilaterally to a negotiated system

Until June 2001, the minimum wage was determined solely by the Government as a minimum net amount which employers had to pay their workers. Between June 2001 and 1 January 2002, the minimum wage was anchored as a gross amount, amounting to 35 per cent of the gross wage.¹⁰ However, minimum mandatory social security contributions were calculated at 40 per cent of the average wage, and until 2004 the mandatory rates were even larger for those with a higher education that paradoxically resulted in a lower net wage for such employees.

From the beginning of 2002, the minimum wage was negotiated between the Government and the representative trade unions and employers' associations. From 1 January 2005, the minimum wage was determined as a net hourly amount, and was also expressed in monthly equivalents and gross amounts, according to the decision made twice a year by the tripartite Socio-economic Council.¹¹ However if agreement cannot be reached about the amount, the government makes the final decision.

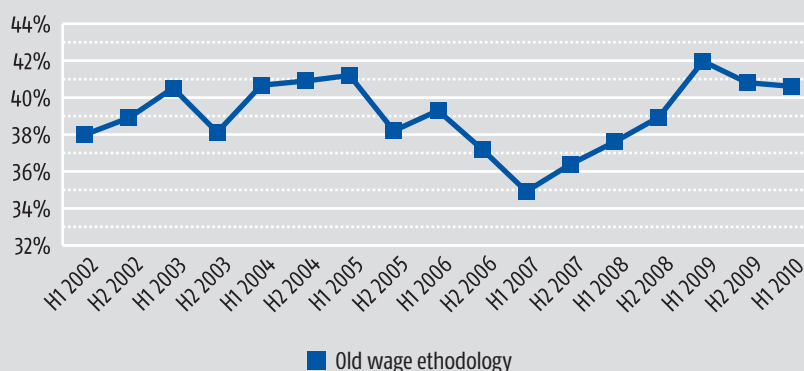
Minimum wage growth was stable during the observed period and kept up with the growth of the average wage. It remained at around 40 per cent of the average wage in Serbia, albeit slowly and

10 Article 65 of the Labour Relations Act.

11 Registar propisa, No. 1, Belgrade, 2009.

continuously decreasing (see Figure 5.2). According to the World Bank (2006), relative to average wages, Serbia's minimum wage is in the middle of the range by regional standards.

FIGURE 5.2 | MINIMUM WAGE/AVERAGE WAGE, SERBIA, 2002–2010



Source: RAD survey, Serbian Statistical Office; Official Gazette, 2002–2010.

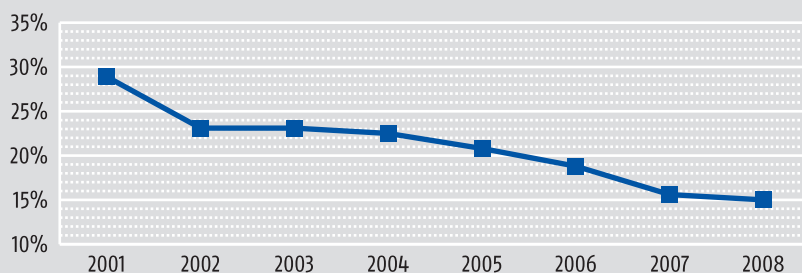
3.2.2 | Minimum wage compliance problems

Furthermore, the minimum wage has proved not to be fully binding for a number of employers, since the official conditions for its payment are that the employee works the full number of hours per month, as well as perform at a vaguely defined “standard productivity rate.” This leaves much room for free interpretation, especially in those sectors of the economy where trade unions are weak. For example, the average wage paid out in the textile and fur production industries is lower than the minimum wage. Therefore, the minimum wage has probably not had much impact on the average wage nor exerted a pronounced negative effect on formal low-wage employment. However, much more damage has been done by the minimum mandatory social security contribution policy, which we discussed in the previous section.

3.2.3 | Basic social assistance losing ground

The average amount paid out as the basic social assistance for one individual (the so-called MOP) could be used as a proxy for a subsistence minimum,¹² so that we looked at its share in the average wage between 2001 and 2008 (see Figure 5.3). However, during this period, it clearly decreased as a share of the average wage, from above 23 per cent to 15 per cent in 2008. This means that MOP payments are so low that they barely reach the food poverty line which, according to the 2007 LSMS, was around 4,000 dinars.

¹² This is the closest proxy for the subsistence minimum in Serbia which can be followed throughout the entire period of analysis (the Republic Statistical Office does not calculate a median wage).

FIGURE 5.3 | SUBSISTENCE MINIMUM/AVERAGE WAGE, SERBIA, 2001–2008

Source: RAD survey, Serbian Statistical Office; Ministry of Labour and Social Policy, 2001–08.

3.3 | The gender pay gap and gender equality initiatives

Since sex-disaggregated wage data cannot be obtained from the RAD survey, which is the main source of wage statistics in Serbia, a number of studies have used LFS data which, although not entirely reliable, are indicative of the wage gap between the genders. According to Babovic (2008), the gender pay gap in Serbia has been fairly stable since 2000. A number of studies, including Babovic (2008) and Krstic (2003) indicate that the difference between the average payment of men and women per hour of work, controlling for other factors, has been 15–16 per cent. This gap is in line with the EU, where women continued to earn an average of 17.6 per cent less than men in 2007 (European Commission, 2009). In addition, the gender gap in Serbia is still among the lowest among the transition countries (Krstic, 2003). At the same time, the retirement age in Serbia is five years lower for women than for men, which is sometimes used as an additional argument highlighting that lifetime gender discrimination is not high in Serbia.

There are, however, indications that the overall gender labour market gap in Serbia is higher than the observed 15 per cent, although this is not detectable from the national wage statistics. Employed women tend to be better educated than employed men, in contrast to the general population. This is an indication of the discrimination and social barriers in labour market entry for women. Most women who do work are well educated and “segregated” in “female sectors”, such as health care or education. Naturally, the wages of high skilled women are higher than the wages of low skilled men but this does not offer a full gender pay gap picture in unadjusted national wage averages. It is therefore necessary to direct a greater effort towards researching the more intrinsic sources of wage inequality between women and men in Serbia.

The national strategic and legal framework for the promotion of gender equality in Serbia is comprehensive and in line with the Millennium Development Goals (MDGs) and the Poverty Reduction Strategy Paper (PRSP). The Labour Code of 2005 is harmonized with EU and ILO standards, and prohibits any gender-based discrimination against those seeking work or those already employed. The Anti-Discrimination Act adopted in March 2009 also prohibits gender-based discrimination in employment, as does the Employment and Unemployment Insurance Act, adopted in May 2009. Finally, the draft Gender Equality Act was adopted and entered into force in December 2009. This law is also based on the equal

opportunity principle in the labour market and represents a significant step towards the harmonization of the national legal framework with the *acquis communautaire*.

The Gender Equality Council has not met for two years, and therefore its role in gender mainstreaming in Serbia is perceived as very weak. At the same time, the Gender Equality Directorate was founded in 2008, and a Strategy on Improving the Position of Women and Gender Equality which recognizes women's disadvantageous position in the labour market was adopted in February 2009.

Serbia is also a signatory of a number of important international conventions on equal remuneration for work of equal value (for example, the Discrimination (Employment and Occupation) Convention, 1958 (No. 111), the UN Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), 1979 and the International Covenant on Economic, Social and Cultural Rights, 1966. Although these strategic and legal documents strongly emphasize the need for adequate statistical data on the position of women in all spheres of life, including the labour market, in order to monitor changes in their status over time, the Serbian strategic and legal framework for statistics and data collection practices in the labour market is not entirely coherent and gender sensitive. This obstructs the effective monitoring of women in the labour market and the assessment of efforts to mainstream gender equality into public policy. For example, the Official Statistics Act adopted by the Parliament in December 2009 simply indicates that data be disaggregated by gender "whenever possible". This means that in the current statistics, sex is perceived as one of many statistical classifications instead of being the basic categorization for all indicators. In light of this weakness of the statistical system, efforts are directed towards improving the monitoring of statistical indicators on gender equality including those relevant to the labour market.

4 | The economic changes brought by the crisis

4.1 Macroeconomic context: A halt to the previous growth model?

The first direct effects of the crisis were felt in the last quarter of 2008. At first, this took the form of a moderate but still rather disconcerting bank panic in October 2008, accompanied by strong downward pressure on the dinar. The government and the central bank reacted fairly quickly to restore confidence in the banks and stabilize the currency. The deposit insurance guarantees for individual savings accounts were increased manifold to 50,000 euros. Furthermore, the personal income tax law was changed which temporarily relieved savings deposits in foreign currency from taxation. Following some other Eastern European countries, the National Bank of Serbia increased the interest rate by 2.5 per cent in a single move in October 2008 to stabilize the dinar and curb the ever present inflation.

Although the collapse of the monetary and banking system was prevented, by the end of 2008 it had become apparent that the demand-driven growth model, fuelled by remittances and FDI, mostly from the proceeds of privatization, had come to an end. The country sank into recession, the GDP fell in 2009 by 3 per cent (year-on-year), and started to recover slowly from the first half of 2010 – the second quarter of 2010 saw 1.8 per cent GDP growth. During the same period, aggregate demand fell by a double-digit percentage on a year-on-year basis. Three-quarters of that fall was due to the decline

in domestic demand – mostly because of a reduced availability of loans for both firms and households and a drop in export demand. It is important to note that the total wage bill and public consumption are the two components of domestic demand that remained fairly stable in 2009 (see Table 5.7 for this and the subsequent analysis).

TABLE 5.7 | MACROECONOMIC INDICATORS, SERBIA, 2008–2010

	2008				2009				2010	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Prices and the Exchange Rate										
Consumer price index, y-o-y	11.8	12.1	9.9	6.8	9.4	8.3	7.3	6.6	4.7	4.2
Nominal exchange rate dinar/euro (€) (period average)	82.6	81.1	77.1	85.0	93.9	94.2	93.2	94.5	98.7	101.4
Economic Growth	Annual real growth									
GDP (in billions of dinars)	601	671	723	744	632	706	745	772	675	763
GDP (in millions of euros)	7,275	8,273	9,367	8,761	6,732	7,495	7,993	8,166	6,841 ¹⁾	7,523 ¹⁾
GDP, % growth y-o-y	8.5	6.3	4.9	2.9	-4.1	-4.2	-2.3	-1.6	0.6	1.8 ¹⁾
Fiscal data	in % of GDP									
RS budget deficit/surplus	-0.1	-2.8	1.6	-1.8	-1.4	-6.0	-2.5	-3.3	-3.1	-3.7
Overall fiscal balance (GFS definition) ²⁾	8.0	-19.6	-5.9	-51.3	-12.4	-45.5	-23.9	-40.0	-24.2	-31.3
Public Revenues	7.6	5.2	2.8	-0.7	-12.6	-13.4	-4.2	-5.0	-4.0	2.5
Public Expenditures	3.8	21.7	-0.4	-3.5	-3.4	-6.0	-0.3	-9.2	-1.3	-3.0
Balance of Payments	in millions of euros flows									
Imports of goods	-4,123	-4,666	-4,855	-4,340	-3,201	-3,186	-3,312	-3,538	-3,214	-3,611
Exports of goods	2,348	2,606	2,798	2,417	1,859	2,135	2,219	2,266	2,009	2,506
Current account	-1,303	-1,764	-1,528	-1,298	-818	-175	-278	-472	-760	-542
in % GDP	-17.9	-21.3	-16.3	-14.8	-12.1	-2.3	-3.5	-5.8	-11.1	-7.2
Foreign direct investments	831	656	133	210	643	251	113	366	284	136
RS public debt (external internal), % of GDP	29.8	26.9	25.4	25.4	27.1	29.2	31.9	32.4	33.6	35.4
NBS foreign exchange reserves	9,553	9,107	9,694	8,160	8,113	8,885	9,523	10,602	10,444	10,493

Notes:

1) In the first quarter of 2008, NBS changed the Balance of Payments methodology. Due to this change, there is a drop in current account deficit, and a decrease in the capital account balance.

2) The overall fiscal result (fiscal balance according to GFS 2001) – Consolidated surplus/deficit adjusted for “budgetary lending” (lending minus repayment according to the old GFS).

Source: National Bank of Serbia (NBS), Foundation for Advancement of Economics (FREN), 2008–2010.

Due to the sharp reduction in demand, the recession has brought about significant but temporary improvements in Serbia's external and internal deficits. For example by mid-2009 the current account deficit had fallen to only 2.1 per cent of GDP compared with 20.1 per cent of GDP in the same period in 2008. The trade deficit was also 40 per cent lower in relative terms than in 2008. Contrary to initial

predictions, remittances continued to grow in 2009 and improved the external balance of payment. These trends have led to the nominal stabilization and slight real appreciation of the dinar.

Inflation, as a measure of internal balance, remained relatively high but this growth was driven largely by the increase in regulated prices. CPI growth in 2009 was 6.6 per cent. However, most of this growth was due to increases in regulated prices including oil, while market prices have remained fairly stable.

Fiscal policy has been under considerable pressure. The real decline in public revenues has been dramatic and largely reflects the fall in domestic demand. In the second quarter of 2009, public revenues were 13.6 per cent lower in real terms than in the corresponding period of 2008. Consolidated public spending in the same period also dropped but significantly less – 6 per cent – which widened the consolidated budget deficit to as much as 6 per cent of GDP. In the structure of public expenditure, the most significant drop was recorded in capital investment while there was an increase in social transfers.

The deficit of the consolidated budget reached 4.5 per cent of GDP in 2009 and was expected to be at around the same level in 2010. The deficit had to be covered by government borrowing abroad and on the domestic financial market. Although the level of public debt, 32.5 per cent of GDP, does not appear to be overly worrisome, longer term projections certainly are. Even with the reduction in the deficit in the coming years, public debt will in the medium term probably surpass 40 per cent of GDP, at which point its annual servicing costs would reach two per cent of GDP. Without the reduction, however, public debt projections are even higher and servicing costs prohibitively high and unsustainable. In order to keep the public debt at a manageable level, the Government will have to adjust not only the budgetary expenditure but the revenue side as well, which might entail tax increases.

Due to the economic crisis, FDI slowed down in 2009 to reach around 1.3 billion euros. However, according to most estimates, in order to sustain high levels of economic growth, FDI needed to be around 3 billion euros per year. Apart from the fact that the ongoing global economic crisis made the attraction of FDI more difficult after the sale of most Serbia's assets to foreign investors the Government has to start attracting greenfield FDI which is a challenging proposition considering the country's rather low international competitiveness.

The Serbian economy largely depends on the availability of credit and investment from abroad, and annually receives about nine per cent of GDP in the form of remittances. GDP growth projections for the years 2010–13 indicate a slow recovery, with around 1.5 per cent growth in 2010 and only three per cent growth in 2011. This is based on ongoing developments in the global economy as well as new fiscal policies adopted in line with the IMF programme (World Bank, 2009).

TABLE 5.8 | MAIN MACROECONOMIC INDICATORS, SERBIA, 2008–2010

	2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	2009	Q1 2010	Q2 2010
GDP	33,418	6,732	7,495	7,993	8,166	30,385 ¹⁾	6,841 ¹⁾	7,523 ¹⁾
Real GDP growth	5.4	-4.1	-4.2	-2.3	-1.6	-3.0	0.6	1.8 ¹⁾
Inflation (CPI)	8.6	9.4	8.3	7.3	6.6	6.6	4.7	4.2
Imports, growth rate in %	15.3	-22.5	-31.7	-30.8	-17.6	-26.0	-4.4	10.8
Export, growth rate in	16.9	-21.2	-18.2	-20.2	-5.8	-16.5	8.1	17.3
Current account balance, % of GDP	-18.2	-12.1	-2.3	-3.5	-5.8	-5.7	-11.1	-7.2
Overall fiscal balance (GFS definition) ²⁾	-68.9	-12.4	-45.5	-23.9	-40	-121.8	-24.2	-31.3
Nominal fx dinar/euro (€) (period average)	81.4	93.9	94.2	93.2	94.5	94.0	98.7	101.4
Budget deficit, % of GDP	-1.8	-1.4	-6.0	-2.5	-3.3	-3.4	-3.1	-3.7
Public debt, % of GDP	26.3	27.1	29.2	31.9	32.4	32.4	33.6	35.4

Notes:

1) NBS estimates.

2) The overall fiscal result (fiscal balance according to GFS 2001) – Consolidated surplus/deficit adjusted for “budgetary lending” (lending minus repayment according to the old GFS).

Source: National Bank of Serbia (NBS), 2008–2010.

4.2 | Labour force adjustments

4.2.1 | A dramatic impact on registered unemployment

The available data from the LFS, establishment surveys and NES registers suggest that the impact of the crisis on the labour force has been quite dramatic. All three sources of information point to a fall in employment and an increase in unemployment and inactivity. It is an internationally well-established fact (see for example ILO, 2009) that the full impact of the crisis on the labour market will typically be felt with some delay, and that decline in employment might last significantly longer than the GDP decline. With this in mind, the deterioration in labour force balance has actually been rather rapid and strong.

Since Labour Force Surveys are conducted semi-annually, the most relevant LFS data for our crisis impact analysis are available at five points in time: April 2008, October 2008, April 2009, October 2009 and April 2010. The October 2008 data, with a snapshot of the labour market situation immediately preceding the outbreak of the crisis, are most useful for comparisons with the April 2010, the latest LFS data available following the start of the crisis. On the other hand, it is also useful to take into account the data from April 2008, because they provide year-on-year comparisons and do not require seasonal considerations. In both cases, it should be noted again that the differences in main labour indicators “before” and “after” do not only reflect the effect of the crisis. They also impact other autonomous economic factors, including the highly significant and ongoing process of transition and privatization in their advanced stages.

Comparing the aggregate employment data from the two furthest “before” and “after” points, the drop in employment since the start of the crisis looks rather dramatic. While employment reached its record low in April 2010, unemployment peaked. The estimated number of employed working age people fell by almost 370,000, or about 14 per cent, between October 2008 and April 2010. This has led to

a drop in the corresponding employment rate for persons aged 15–64 from 53.3 per cent to 47.2 per cent. During the same period, the number of unemployed increased by some 115,000 persons and represented a jump in the unemployment rate from 14.7 per cent to 20.1 per cent.

TABLE 5.9 | EMPLOYMENT AND UNEMPLOYMENT TRENDS, SERBIA, 2008–2010

		Number of employed 15–64			Employment rate 15–64			Total number of unemployed 15–64			Unemployment rate 15–64		
		Total	Female	Male	Total	Female	Male	Total	Female	Male	Total	Female	Male
2008	April	2,652,429	1,150,004	1,502,425	54.0	46.0	62.3	432,730	219,879	212,851	14.0	16.1	12.4
2008	October	2,646,222	1,122,835	1,523,387	53.3	44.7	62.2	457,205	235,468	221,737	14.7	17.3	12.7
2009	April	2,486,734	1,081,108	1,405,626	50.8	43.3	58.7	486,858	238,820	248,038	16.4	18.1	15.0
2009	October	2,450,643	1,058,767	1,391,875	50.0	42.7	57.4	516,990	250,562	266,427	17.4	19.1	16.1
2010	April	2,278,504	977,548	1,300,957	47.2	40.3	54.3	572,502	259,062	313,440	20.1	21.0	19.4

Source: Labour Force Survey, Serbian Statistical Office, different years.

Looking more closely at the structure of employment (SSO, 2009) it comes as no surprise that the impact of the crisis has primarily affected people in vulnerable jobs, such as those in self-employment, flexible employment contracts and informal employment. The initial adjustment of the private sector has resulted in employment cuts for workers on fixed term or service contracts and an above average fall in self-employment.

A much smaller increase in unemployment numbers compared to the employment decline suggests that a significant number of out of work people between October 2008 and April 2010 simply became inactive and stopped looking for work. Most notably, the most prominent drop in employment – around 32.3 per cent – has been recorded in the youngest working age 15–24 group. But at the same time, unemployment in this same age group is falling as well which suggests that young people in times of crisis opt to continue their education as a fallback option. The drop in employment of the youngest working age is followed by the 18 per cent employment fall within the 25–34 age group. Another strongly affected group are persons between 45 and 54 years of age, with a total drop in employment of around 13 per cent. Unlike young people, in this older age group the fall in employment is accompanied by an increase in unemployment. These two humps are indicative of the two main sources of the fall in employment. It may be hypothesized that the impact of the crisis is felt most intensely by the 15–34 age groups following both cancellations of existing fixed-term and service contracts and the decline in new vacancies. On the other hand, the 45–54 age group is perhaps particularly affected by the completion of privatization and enterprise restructuring and the mounting number of bankruptcies and liquidations afterward.

4.2.2 | A fall in formal employment confirmed by establishment surveys and unemployment registers

Two other important sources of labour force statistics are establishment surveys (RAD) and NES registers. Although both surveys are incomplete and based on administrative data, they have some features which

make them indispensable for the analysis of the effects of the crisis. First, these data are available on a monthly basis, although incomplete and with serious methodological problems in the case of establishment surveys. Second, in times of crisis these surveys are even more useful, precisely because they provide information exclusively on trends in the formal labour market – that is establishment surveys report only on formal employees and self-owned businesses, while NES registers reports on trends in the registered unemployed. It might be expected that the response of the formal labour market to the crisis would be strongly pro-cyclical, which is not the case with the informal labour market, which can react counter-cyclically. For example, persons who lose “good” formal jobs can be forced into informal work if they cannot afford unemployment or inactivity. This assumes the absence of change in aggregate LFS employment. But on the other hand, the drop in formal employment will be visible in establishment survey statistics. Therefore, the following formal labour trends provide more points for analysis and perhaps provide a clearer picture of the full impact of the crisis.

Looking at Table 5.10, which presents the dynamics of formal employment as revealed by the establishment surveys, we notice only a slight fall in establishment legal entity employment which has contributed to a cumulative fall between October 2008 and July 2009 of as little as 16,000 persons. There is a huge drop in private sector employment recorded in March 2009 but since the Health Insurance Fund cleared its database in January 2009 of people who failed to pay their regular health insurance we cannot fully understand how the crisis contributed to this drop as well.

However, in the second phase of the crisis – between September 2009 and March 2010 – administrative data on employment show a significant decline by 2.8 per cent or 51,000 people – of formally employed workers. Employment in legal entities fell by 1.5 per cent (21,000 people) in the same period. There was a simultaneous drop in the number of self-owned businesses and their workers by 6.5 per cent (around 30,000 people).

TABLE 5.10 | FORMAL EMPLOYMENT (EXCLUDING FARMERS), SERBIA, 2008–2010
('000 PERSONS)

	Total employed	Employed with legal entities	Self-owned businesses			Total employees
			Total	Self-owned businesses	Their employees	
2008						
January	1,989	1,416	573	245	328	1,744
February	1,989	1,416	573	245	328	1,744
March	2,006	1,432	574	245	329	1,761
April	2,003	1,429	574	245	329	1,758
May	2,002	1,428	574	245	329	1,757
June	2,000	1,426	574	245	329	1,755
July	1,998	1,424	574	245	329	1,753
August	1,999	1,425	574	245	329	1,754
September	1,993	1,425	568	245	323	1,748
October	1,994	1,426	568	245	323	1,749
November	1,992	1,424	568	245	323	1,747
December	1,992	1,424	568	245	323	1,747
2009						
January	1,983	1,416	568	209	359	1,775
February	1,981	1,413	568	209	359	1,772
March	1,911	1,411	500	210	290	1,701
April	1,907	1,407	500	210	290	1,697
May	1,900	1,400	500	210	290	1,690
June	1,896	1,396	500	210	290	1,686
July	1,893	1,393	500	210	290	1,683
August	1,886	1,386	500	210	290	1,676
September	1,868	1,383	485	211	274	1,657
October	1,864	1,379	485	211	274	1,653
November	1,862	1,377	485	211	274	1,651
December	1,858	1,373	485	211	274	1,647
2010						
January	1,851	1,366	485	211	274	1,640
February	1,846	1,362	485	211	274	1,636
March	1,817	1,362	455	199	257	1,618

Source: RAD survey, Serbian Statistical Office, 2008–2010.

It should also be noted that the public sector, employing around 480,000 people, did not report any significant drop in employment between 2008 and 2010 – around 5,000 employees lost their jobs (see Table 5.11).

**TABLE 5.11 | EMPLOYEES BY OWNERSHIP SECTOR
(EXCL. SELF-OWNED BUSINESSES), SERBIA, 2004–2010**

		Public sector						Other ¹⁾
		From the budget			Public enterprises		Total	
		Adminis- tration all levels	Education and culture	Health and social work	National public	Local public		
2004	March	63	117	147	125	57	509	1,092
	September	63	116	148	124	57	508	1,052
2005	March	63	119	148	122	61	513	1,044
	September	61	117	147	112	61	498	1,038
2006	March	60	118	141	105	61	485	1,011
	September	58	117	138	102	60	475	972
2007	March	58	121	138	100	59	476	962
	September	59	120	139	100	58	476	952
2008	March	60	124	140	99	58	481	951
	September	61	122	141	100	58	482	943
2009	March	64	125	142	89	57	478	933
	September	64	123	142	88	57	473	910
2010	March	62	124	142	87	56	472	890

Note: Those employed in the Ministry of Defence and the Ministry of the Interior even though financed from the budget do not enter the total balance of the employed persons presented in this table. Their numbers are estimated at around 80,000, and they add another 4% to the total number of employed in Serbia. The data on their exact numbers and wages are not published by the SSO because of national security concerns.

1) Private, socially-owned and mixed ownership enterprises (without self-owned businesses). This column is not disaggregated further due to data availability limitations. The number presented in column 7 is calculated by subtracting the total number of employees.

Source: SSO, 2004–2010.

4.2.3 | Monthly data showing strong unemployment growth until mid-2010

Current administrative data on unemployment is estimated to have overstated the number of economically unemployed by at least 50 per cent. Still, if we assume a constant ratio between the “true” and “false” unemployed in the NES records, it is possible to get some indication of the unemployment trends on a monthly basis.

The number of registered unemployed increased by 36,000 (5 per cent) between September 2008 and May 2010. But the level has stagnated at around 760,000 since then. The number of registered unemployed is still lower than in March 2008 (see Table 5.12). Observing gender differences in unemployment records, there has been a higher influx of male registrants with NES since the onset of the crisis. This can be explained by male dominance in the private sector labour market which has adjusted itself to economic change through employment reduction – in contrast to the female dominated public services.

TABLE 5.12 | REGISTERED UNEMPLOYED, SERBIA, 2008–2010

	Total	Female	Male
2008			
August	733,680	399,938	333,742
September	726,465	395,440	331,025
October	717,405	391,265	326,140
November	718,256	390,504	327,752
December	727,621	392,733	334,888
2009			
January	736,816	395,237	341,579
February	749,691	400,165	349,526
March	758,387	402,970	355,417
April	762,674	405,082	357,592
May	767,547	407,514	360,033
June	763,062	403,975	359,087
July	756,662	402,632	354,030
August	747,456	399,171	348,285
September	737,160	393,094	344,066
October	727,142	387,847	339,295
November	723,350	384,693	338,657
December	730,372	386,125	344,247
2010			
January	751,590	395,087	356,503
February	767,418	401,310	366,108
March	778,505	405,068	373,437
April	772,184	401,935	370,249
May	762,592	397,423	365,169

Source: National Employment Service, 2008–2010.

5 | How much have wages been affected by the crisis?

5.1 | A slowdown but no reversal in wage growth

The most important feature of wage trends is that average wages as measured by the RAD have not shown signs of reversal although they have slowed down since the outbreak of the crisis. Real annual average wage growth was 4.1 per cent in the fourth quarter of 2008 which was very much in line with its overall growth in 2008. In 2009, real average wage growth halted or in other words increased by only 0.6 per cent (see Table 5.13). The fact that real wages have not declined during the crisis comes as a surprise. It suggests that labour market adjustments in the formal economy have occurred predominantly through employment cuts, rather than through real wage cuts.

TABLE 5.13 | AVERAGE MONTHLY WAGES AND YEAR-ON-YEAR INDICES, SERBIA, 2008–2010

	Gross, in dinars	Net, in dinars	Gross, in euros	Net, in euros	Nominal	Real
	1	2	3	4	5	6
2008	40,612	29,174	498	357	117.8	104.4
2009	44,182	31,758	470	337	108.8	100.6
2008						
Q1	37,284	26,814	451	324	119.3	105.2
Q2	40,162	28,846	495	356	119.4	103.1
Q3	40,986	29,435	531	382	117.9	105.0
Q4	44,018	31,599	518	366	115.1	104.1
December	47,836	34,348		388	112.0	103.1
2009						
Q1	41,937	30,120	445	320	112.5	102.2
Q2	44,244	31,808	468	337	110.2	101.3
Q3	44,160	31,737	474	340	107.7	99.8
Q4	46,386	33,366	491	353	105.4	99.5
December	51,115	36,789	533	383	106.9	100.2
2010						
Q1	44,326	31,924	446	324	105.7	101.1
Q2	47,488	34,192	465	335	107.3	103.2

Notes:

- Total labour costs represent author's calculations based on SS0 gross wage data.
- Average wage data presented in this table are based on the new wage calculation methodology.

Source: Serbian Statistical Office (SSO) for gross and net wages, 2008–2010.

5.2 | Differentiated wage adjustments between private and public sector

However, looking at the pattern of wage adjustment by sectors (public vs. private) in Table 5.14, the picture becomes more complex, with diverging trends across the two sectors. It appears that from January 2009 the public sector started to adjust through real wage cuts even as the private sector average wages continued to grow at roughly the same pace as before the crisis. In the public sector, the wage fall has been most prominent in administration (more than 6 per cent at the end of 2009) but it has been present in all other groups as well. The drop in wages in administration comes as no surprise as it stems from the Government's January 2009 decision to cut average wages by 10 per cent, as well as freeze all other wages in administration. Given the freeze of public sector wages, the increase in 2010 in the average wage statistics in administration can only be attributed to the cuts in the number of lower paid workers.

TABLE 5.14 | GROSS WAGES, SERBIA, 2008–2010 (YEAR-ON-YEAR REAL INDICES)

	Budget			Public enterprises		Private sector, including employees of self-owned businesses	Serbia average
	Administration all levels	Education and culture	Health and social work	Central	Local		
	1	2	3	4	5		
2008							
Q1	99.2	109.5	105.6	94.3	98.5	107.3	105.2
Q2	99.6	104.8	99.4	103.0	89.0	104.2	103.1
Q3	100.8	104.7	101.1	103.6	91.7	106.3	105.0
Q4	103.3	103.7	99.2	103.9	104.4	105.1	104.1
2009							
Q1	99.8	97.9	99.4	98.4	100.8	105.1	102.5
Q2	94.0	97.4	98.1	99.0	99.3	104.8	102.0
Q3	93.6	96.2	96.9	98.1	95.4	102.9	100.1
Q4	93.0	93.6	93.5	96.0	95.9	104.0	99.9
2010							
Q1	95.8	96.1	96.1	102.2	98.0	103.5	101.1
Q2	101.0	96.7	95.1	102.1	98.3	106.6	103.2

Source: Serbian Statistical Office, 2008–2010.

Still, it is counterintuitive to witness growing real wages in the private sector amid deep recession. Here we offer some tentative explanations of this trend.

5.3 | Explanations of private sector wage growth

5.3.1 | The role of the minimum wage

First, the minimum wage was raised by 11 per cent in nominal terms in January 2009, largely as compensation from the Government to the unions for their acceptance of the postponement of the full implementation of the General Collective Agreement. This postponement turned out to be practically indefinite. Since the concentration of minimum wage recipients or those receiving only slightly higher wages is rather high in the private sector, unlike in the public sector, this has pushed up average wages in that sector. This is especially true for those who are employed by small businesses, since for more than half of them are only officially paid at the minimum wage level. Of course, some or even most of these employees earn more, in the form of unreported “envelope” wages but these are impossible to capture. Within private sector establishments, the biggest annual real wage growth between 2009 and 2008 was registered in the hotels and restaurants sector (17.8 per cent) and in the wholesale and retail trade (12 per cent). Both are predominantly low-wage sectors which further confirms our hypothesis about the impact of the minimum wage increase on average wage trends after January 2009.

5.3.2 | Changed methodology for employees in small businesses

Second – and probably as important as the increase in the minimum wage – because of the changed methodology with regard to the coverage of employees in small businesses, their number fell significantly from January 2009, as shown in Section 4. Since the majority of them receive only the minimum wage, their reduced numbers have contributed to the increase in overall average wages in the private sector.

5.3.3 | Removing low-paid second tier employment

Next, because of the elevated hiring and firing costs for employees on open-ended contracts, most firms have developed a two-tier system, with employees on fixed-term and less secure lower wage service contracts. The latter accounts for most of the overall labour turnover. We can hypothesize – and this is supported by abundant anecdotal evidence – that some firms have responded to the crisis by cutting second-tier employment. As a result, the average wage of the remaining employees went up.

Finally, the process of privatization and enterprise restructuring is coming to an end. Overlapping with the crisis, they led to many bankruptcies and liquidations and in the process removed some troublesome low-wage firms from the RAD 50+ sample.¹³

5.4 | The ups and downs of the labour share

Analysing labour share trends is probably the most comprehensive way to assess the overall impact of the crisis on the labour market since, by definition, the labour share simultaneously captures adjustments in both quantities (employment) and prices (wages) in the national labour market relative to adjustments in GDP. The methodology we used to calculate labour share in Serbia was described in Section 2.3.4.

As shown in Table 5.15 in 2009 the total wage bill in Serbia fell much less than GDP in comparison to the same period in 2008. Expressed in constant 2002 dinars, the fall in GDP was 41.6 billion dinars, while the fall in the wage bill was only 14.5 billion dinars. This led to an increase in the labour share – in the first quarter from 44.8 per cent in 2008 to 47.1 per cent in 2009, and in the second quarter from 42.9 per cent in 2008 to 44.1 per cent in 2009. However, in the second half of 2009 and the first half of 2010, the labour share started dropping and returned to its pre-crisis levels. The overall stability of the wage bill and labour share trends could be considered an important and favourable flexibility feature of the Serbian adjustment process to the crisis.

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Companies with more than 50 employees.

TABLE 5.15 | LABOUR SHARE TRENDS, SERBIA, 2008–2010

	GDP (constant prices 2002)	Wage bill (based on total labour cost)	Labour share
in '000 dinars			
2008	1,351,815,200	582,079,192	43.1
2009	1,310,178,000	567,592,585	43.3
Q1 2008	308,480,200	138,134,497	44.8
Q2 2008	335,242,400	143,904,899	42.9
Q3 2008	350,366,500	146,273,482	41.7
Q4 2008	357,726,100	153,266,594	42.8
Q1 2009	296,989,200	139,793,120	47.1
Q2 2009	321,275,500	141,681,860	44.1
Q3 2009	341,364,200	140,230,709	41.1
Q4 2009	350,549,100	145,517,097	41.5
Q1 2010	298,221,700	135,090,754	45.3
Q2 2010	327,738,700	140,845,911	43.0

Source: Serbian Statistical Office, 2008–2010, and author's calculations.

In an attempt to tentatively explain relatively favourable labour share trends there are two factors to be considered – the significant minimum wage increase in January 2009 and within the general framework of reduced government expenditure in 2009, the changed structure favouring wages at the expense of capital investment. However, the effects of both these factors will not last long. The minimum wage, for the first time since 2001, remained unchanged in July 2009 and increased only moderately in the first half of 2010 – 3 per cent annual growth – on the grounds that its relative level to the average wage was too high. Secondly, as explained in Section 4, further budgetary cuts are planned. A reduction in the public sector wage bill was pursued in 2010–11 – albeit with very modest results.

6 | Wage policy responses

6.1 | The role of the IMF in fiscal policy

The first outbreak of the crisis took the form of a moderate – but still fairly disconcerting – run on the banks in October 2008, accompanied by strong downward pressures on the dinar. The government and central bank reacted fairly quickly to restore confidence in the banks and stabilize the currency. The deposit insurance guarantees for individual savings accounts were increased substantially, to 50,000 euros. Furthermore, the personal income tax law was changed, and savings deposits in foreign currency were given temporary relief from taxation. Following some other Eastern European countries, the Serbian National Bank increased the interest rate by 2.5 percentage points in a single move in October 2008 to stabilize the dinar and curb inflation. In addition, significant foreign currency reserves were spent to defend the dinar. In an attempt to revive its crumbling stock exchange, hastily abandoned by most foreign participants, Serbia also abolished its capital gains tax which contributed to a further fall in

stock exchange indices. A quantitatively modest but psychologically very important stand-by agreement with the IMF was concluded as early as December 2008 (approved in January 2009) in order to help restore confidence in the dinar and in the national banking system.

As the situation in the foreign currency markets and the banking sector started to stabilize, and inflation pressures weakened, in early 2009 moves were made in the opposite direction towards a more relaxed monetary policy – including the lowering of interest rates. This is now one of the main counter-cyclical economic policies given the need for careful management of fiscal policy in order to preserve macroeconomic stability.

Since early 2009, practically the entire burden of policy adjustment to the crisis has been moved to fiscal policy. Substantial reductions in public expenditure and tax increases were initially presented as part of the IMF conditions for approval of a massive extension of the Stand-by Agreement to some 3 billion euros to help fill the projected external financing gap in 2009–11.

Negotiations with the IMF resulted in an agreement signed in April 2009 (IMF, 2009). Most of the required fiscal adjustment would be achieved through cuts in public expenditure rather than through increases in revenues and consequently, taxes, except for customs duties and other minor property tax items. The initial approach of increasing revenues included a VAT increase of one or two percentage points from the present 18 per cent and the introduction of the so-called “solidarity tax” – the latter, an additional wage tax, would be assessed on employees with above average wages either only in the public sector or universally. A proposed variant of the solidarity tax – which caused a public outcry – included its introduction at rather low wage levels and extended its coverage to pensions, which are not taxable under Serbian legislation. All these ideas were dropped, although the tax increases might still be introduced if the follow-up IMF staff reviews show that the spending cuts were insufficient to curb the budget deficit.

In return for the IMF agreement not to insist on tax increases, the Serbian government has committed itself to keep wages in the public sector and pensions frozen in nominal terms in 2009 and 2010. A ban on new employment in the public sector was also introduced. Other austerity measures included severe cuts in the discretionary spending of ministries and on non-essential public investment projects, with a priority on strategic projects such as ‘Corridor 10’.

As briefly touched on in Section 4, the government has only partially succeeded in implementing its fiscal adjustment programme which resulted in a fiscal deficit in 2009 of about 3.4 per cent of GDP. In the ongoing second SBA review process the IMF might agree to the larger fiscal deficit, but probably on condition that in mid-term it should be reduced by both further spending cuts and an increase in some key direct personal income or indirect taxes (VAT).

6.2 | The role of the Government and social partners with regard to sustainable wage development

Both the crisis and the IMF conditions imposed some heavy restraints on the social partners' behaviour in 2009. Nevertheless, agreements and negotiations conducted by the end of 2008, even well after the outbreak of the crisis, are indicative of the state of social dialogue in Serbia, which cannot be described as mature and satisfactory.

The whole period after 2000 was characterized by the gradual decline in union strength, which was reflected among other things in the diminishing coverage of employees by collective agreements. By 2008, both the General Collective Agreement (GCA) and most branch collective agreements in sectors outside the public sector had long expired.

Still, before the elections in spring 2008, a new GCA was signed more as a product of the pre-election campaign than as a result of serious negotiations between the social partners. Although it re-affirmed numerous privileges for the unions and employees which had all but disappeared during the transition, the concrete collective bargaining arrangements were left to branch negotiations. However, the GCA contained some far-reaching solutions related to the re-introduction of mandatory fringe benefits and its most important provisions, the hot-meal allowance and the holiday allowance. However, its enforcement was delayed.

The annexed version of the GCA was signed by the social partners amid the crisis, in November 2008. They agreed to a mandatory, fully taxed monthly hot-meal allowance for all employees countrywide in the amount of 15 per cent of the monthly average wage, as well as an annual holiday allowance totalling 75 per cent of the monthly average wage. This move, equivalent to an increase in the total wage bill and total labour costs of around 15 per cent – since only a small number of well-off public firms and institutions already provided these fringe benefits to their employees – was clearly unenforceable, even without the looming crisis (Arandarenko and Arsic 2008). A widespread outcry erupted among the employers, and the Employers' Association encouraged by the government, quickly withdrew its signature from the so-called "extended GCA".

To compensate for its unfulfilled promise, the government made a number of conciliatory moves toward the unions, including the revival of the Socio-Economic Council (SEC), and the creation of several bodies within it with the aim of improving the quality of social dialogue and facilitating the conclusion of branch collective agreements.

The most important concession to the unions was the minimum wage increase of 11 per cent, effective from January 2009. It has already been noted that this increase was probably the most important factor behind the preservation of the rising trend in private sector wages and a decisive contributor to the increase in overall labour share in the first half of 2009.

This double-digit nominal minimum wage increase in January 2009 coincided with the changed methodology for the calculation of average wages, which brought about a fall in the average wage of some 15 per cent in comparison to December 2008. Taken together, these two changes – one real, another methodological – within one month pushed the ratio of the minimum wage to the average wage from around 40 per cent to close to 50 per cent. This comparatively high ratio raises the question of whether the current level of the minimum wage is harmful for formal employment, especially within the context of the crisis.

Our tentative answer is no, at least from the standpoint of the protective role of the minimum wage. It should be noted that in Serbia, with a low flat wage tax of 12 per cent and a modest personal allowance set at around 25 per cent of the minimum wage the gap between the take-home minimum and average wages is pretty much the same as that of their gross wage counterparts. This is different from most OECD countries, where the ratio of the minimum to the average gross wage of 40 per cent

translates into a ratio of 50 per cent for the take-home wage, that is higher than the current ratio in Serbia (see Figure 5.2 in Section 3.2 above).

Harsh economic reality in 2009 further emphasized by the conditions attached to securing IMF loan disbursements, has not been conducive to further progress in social dialogue. None of the branch collective agreements negotiated outside the public sector has been signed, with the Employers' Association refusing to accept differentiated wage coefficients (see SEC analysis, May 2009). Furthermore, for the first time ever, the minimum wage was not raised at the semi-annual SEC negotiations and remained the same for the rest of 2009. The decision was, again for the first time, made unilaterally by the Minister of Labour and Social Policy.

Although the Ministry of Labour and Social Policy, early 2009, floated the idea of a job retention scheme which would allow for government-subsidized shorter working hours as an alternative to redundancies in the private sector, it did not materialize both for lack of money and fears of potential widespread abuse. A number of major foreign-owned export-oriented firms have started such programmes on their own, but with corresponding reductions in wages.

In response to the crisis, active labour market policy measures have been restructured around two major specially designed programmes: public works and a youth apprenticeship scheme. It is estimated that around 10,000 young people will be temporarily employed for six to nine months within the youth apprenticeship scheme which is aimed at facilitating access to jobs for first-time entrants.

Since the average wage in Serbia was methodologically reduced due to the fact that most small business owners and their employees report wages close to the minimum wage, negotiating minimum wage downwards would put pressure on the standard of living, especially since the minimum wage is already not far above the poverty line: the poverty line in 2007 was around 8,000 dinars while the minimum wage amounted to around 10,000 dinars. Therefore, it is important to note that a growing ratio of the minimum wage to the average wage, especially in times of crisis, may indicate not that the minimum wage is too high, but that an increasing number of people are working for precisely the minimum wage. This is when the question of successfully anchoring the minimum wage to the standard of living and purchasing power in order to prevent wage deflation becomes prominent. A careful balance of these issues is of the utmost importance.

7 | Conclusions and policy issues

The crisis has revealed – or further underlined – a number of structural weaknesses in the institutions and policy of wage formation in Serbia, most of them having their roots in the past two decades of delayed and difficult transition to a market economy.

First, the institutions of social dialogue are weak and largely ineffective. Efforts by the Socio-economic Council to provide guidance for the national wage policy have been unsuccessful, nor was this achieved with the effectively suspended General Collective Agreement.

Second, both average wages and the wage bill in the public sector have grown much faster than their counterparts in the private sector, and they were the drivers of wage inflation during much of the past decade. Wages have also grown very fast in financial and other services. On the other hand, average

wages in some traditional manufacturing sectors – such as textiles or food processing – have been below or slightly above the minimum wage. These divergent trends have aggravated the dualization, not only between the formal and informal sectors, but also within the formal labour market.

One of the most important reasons for this sector wage divergence and growing labour market dualization is to be found in an effectively regressive system of wage taxation which was introduced in 2001, some elements of which are still in place. Thus in a sort of perverse “negative tax-based income policy”, the labour taxation system has penalized low-wage sectors and workers and rewarded high wage sectors and workers.

In such a system, the minimum wage has served as a necessary pillar to “make work pay” within the formal labour market. If there has been a negative effect on employment, it has more to do with high minimum bases for social security contributions and comparatively very high tax wedges for low-wage workers.

There is some chance that, out of this crisis, a new consensus on wage institutions and wage policy will emerge, as part of a general acceptance of a need for “a new Serbian growth model”, which will not be demand-driven or based on over-consumption. Instead, it will require export orientation, fiscal responsibility and sustainability.

We shall now sketch a number of recommendations which might help to improve wage policy and wage-defining institutions and be conducive to a new growth model.

First, the institutions of social dialogue and national wage concertation need to be strengthened and their legitimacy confirmed. It is important that they provide general guidance for wage adjustments at the national level in order to dismantle labour market dualization. For that purpose, centralized wage bargaining should be given priority over sector collective negotiations during the recovery phase. Also, wage moderation efforts should be promoted to save jobs which – as comparative evidence from past crises shows – will be threatened for as long as several years after the recovery starts.

Second, the labour taxation system –not only personal income tax but also social security contribution rules– needs to be thoroughly revised. The current structure is both unjust and inefficient and so any move towards more progressive taxation would bring improvements in terms of both efficiency and social justice. Progressive taxation would also open up a role for a tax-based income policy to serve as a balancing factor in relation to wage inflation pressures in the public sector or other monopolies. It would also help to reduce growing or generally high disparities among demographic groups, sectors and regions on the labour market.

Third, both the minimum wage and the tripartite institutional framework, especially in times of crisis, must be preserved. It is important that the minimum wage ratio to the average wage be set at such a level that it makes work pay in comparison to the alternatives. But at the same time it should not push employers into the informal labour market or labour-saving technologies. Reductions in the tax burden for low-wage labour should widen the range of acceptable solutions for both workers and employers.

Labour share should be one of the priority goals of the new economic policy. For this to happen, comprehensive tax and social security contribution reform is required, along with a more progressive labour taxation, and more importantly, a greater reliance on capital and property taxes.

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The Impact of the Crisis on Wages in selected EU Member States

6

Bulgaria: Is a restrictive wage policy the answer to the economic crisis?

VASIL TZANOV

1 | Introduction

During the reforms which started at the beginning of the 1990s, the Bulgarian economy faced periods of both crisis and development. The labour market reforms introduced a modern industrial relations system corresponding to international standards. The wage reforms involved the implementation of collective bargaining as a tool for wage fixing. This allows wage setting in accordance with both workers' and employers' interests.

Generally, wage development moves in tandem with economic development and wage policy. After the profound economic crisis that the Bulgarian economy suffered until the mid-1990s there was a long period of recovery. Wage policy became unrestrictive after the abolition of restrictions on wage growth in the public sector after 1998. Due to this favourable economic environment earnings increased significantly in both nominal and real terms.

The world financial and economic crisis affected the Bulgarian economy with some delay in comparison to many other countries. The recession in Bulgaria started at the beginning of 2009 and

deepened in the course of the year. Economic output progressively contracted, but the effect on wages was very weak. Wage growth in nominal and real terms remained positive throughout the year, but at a decreasing rate. Despite this, the Government launched restrictive wage measures, regardless of the ineffectiveness of such a policy in the transition years.

This study analyses broad aspects of wage development during the years of development and the present crisis. This includes the changes in wage trends, wage policy, relations between wages and economic development and social payments, wage disparity trends and so on. Official statistics are used, but wage data should be interpreted with care because their reliability is questionable. This is due to the existence of a “shadow economy” in which wages are partly received “under the table”. This concerns mainly wages in the private sector.

The main outcomes of the study may be summarized as follows:

- Wage setting mechanisms are based on social dialogue and collective bargaining. The bargaining system is decentralized, although there is a national level. Coordination between levels is weak and there is no strict recommendation on wage fixing mechanisms. The attempt to introduce a more centralized system of wage bargaining and stronger recommendations on wage fixing failed.
- The Bulgarian experience of the implementation of a restrictive wage policy (1990–97) did not bring positive results. Inflation remained high and the economic downturn continued until 1997. As a result, real wages and living standards declined significantly.
- There was considerable progress with regard to wages after changes in wage policy and increasing economic growth in the second half of the transition, after 1997. Nominal and real wages rose but less than GDP. Faster growth of the minimum wage increased its proportion of the average wage and the gap in relation to social benefits.
- The link between wages and economic performance is weak. Employees' remuneration accounts for a relatively small proportion of GDP, with a tendency to decline in recent years. The connection with productivity is also weak. Wage and productivity growth differed significantly in the period of growth before the financial and economic crisis.
- Wage disparity in Bulgaria is relatively low in comparison to other EU countries. Average earnings in the highest pay sector are about four times higher than those in the lowest, with a tendency to decline after 2000. The disparity in relative wages has also declined. There have been above-average increases in wages in public-financed branches (public administration, teachers and doctors). Gender wage differences also became smaller, with the gender pay gap decreasing almost twofold during the period 1996–2006. Earnings in the public sector are higher than in the private but the gap between them was diminishing in the period before the crisis.
- The effect of the crisis on wage development in Bulgaria has been limited. The recession is affecting wages by lowering growth rates. Earnings in nominal and real terms rose throughout 2009. This applies to all economic sectors and branches but to different extents.
- Wage inequality between branches has declined as a result of the crisis and restrictions on public sector wages. Also, the pay gap between the public and the private sectors has fallen because the Government cut the envisaged wage growth in the public sector in the second half of the year.

- The relationship between wages and economic results has remained weak during the crisis. The wage share in GDP initially increased, before gradually declining to its pre-crisis position. The disconnection between wages and productivity has increased since productivity declined but wages rose.

- In response to the crisis the Government has introduced temporary wage restrictions. The Government has frozen the minimum and other wages until mid-2010. These restrictions are aimed at balancing the state budget and reducing labour costs in order to maintain employment. This policy is likely to lead to a decline in real wages and domestic demand. The expected effect on employment is questionable, bearing in mind previous experiences of reducing labour costs with no effect on employment.

2 | Wage setting, social dialogue and wage policy objectives

Wage fixing mechanisms in Bulgaria are based on recent labour legislation (established at the beginning of the 1990s) and ILO conventions on wages. Implementing collective bargaining for the purpose of wage setting brought Bulgaria into line with the developed market economies. Bulgaria has ratified 83 ILO conventions, including those on wages (Conventions 87, 95, 98, 100, 111, 138, 156 and 173). However, the Minimum Wage Fixing Convention (No. 131) has not yet been ratified. Having said that, Bulgaria has long experience of minimum wage fixing. With regard to the practical application of these conventions in Bulgaria, the ILO's Committee of Experts on the Application of Conventions and Recommendations has made recommendations on the provision of more detailed information and explanations (Report of the Committee of Experts, 2009).

2.1 | Social dialogue and wage fixing mechanisms

The basic form of wage setting in Bulgaria is collective bargaining. It could be characterized as national/centralized (for a more detailed explanation, see Tzanov 2008; Beleva and Tzanov 2001). It is not typically centralized because there is no strong coordination between particular negotiating levels. On the other hand, the existence of a national level makes it different from decentralized systems. The various bargaining levels have different degrees of development. In practical terms, it operates at national and company level. The consultative character of bargaining at national level and the prevalence of bargaining at company level mean that the industrial relations systems is similar to a decentralized one. Intermediate social dialogue, which functions at sectoral level, is also underdeveloped, with few collective agreements signed.

The collective bargaining system in Bulgaria is characterized by a relatively low degree of coordination between the separate levels. This concerns not only vertical, but also horizontal coordination. There are several indications of this. First, consultations at national level do not include negotiations on wage levels or development, for the purpose of setting standards for the lower levels (whether recommended or compulsory). Second, no generally accepted (pilot) model for negotiating at branch or industry level exists which could be used as a model for the lower levels. Third, state intervention in wage formation decreased after restrictions on wages in the public sector were removed. At the enterprise level, which

is the dominant one in Bulgaria, negotiations are held between employers and trade unions – that is, there is no state participation.

A change in wage fixing mechanisms was implemented by the “Pact on economic and social development of the Republic of Bulgaria up to 2009”, signed by the social partners in 2005. The social partners agreed to set wages in accordance with inflation, productivity, competitiveness and tax changes. Fixing of the national minimum wage is supposed to take into account the official poverty line and the average wage. However, these agreements were not implemented in practice. The 2005 agreement would considerably strengthen vertical coordination. Social dialogue would become more centralized since decisions taken at national level on average wage increases would be recommended for lower levels, similar to the Hungarian wage-fixing system (see chapter on Hungary in this volume).

There is not much horizontal coordination either. There are no connections and interactions within the framework of collective bargaining in organizations at a given level. Negotiations between the social partners at company or branch level are independent and decisions taken on wage levels or working conditions are not interrelated.

Almost 38 per cent of workers are covered by collective bargaining. There is no information on the dynamics of this indicator. Collective bargaining in Bulgaria covers all workers in the state sector, no matter what their trade union affiliation. This is because the law allows bargaining to include also workers who are not trade union members. Collective bargaining is not widespread in the private sector, existing mostly in large companies in which trade union organizations were preserved intact after privatization. Practice indicates that there are no trade union organizations in newly established medium-sized and large companies. The limited extension of collective bargaining in the private sector is largely due to the prevalence of small enterprises in the Bulgarian economy. Because most small companies have no more than five or six workers it is impossible to establish trade union organizations in them.

In practice, wages in Bulgaria are set at three levels: national, branch and enterprise level. The regional level remains undeveloped. At national level only the national minimum wage is fixed. It is set by the Government after national-level negotiations. At lower levels, minimum wages are the subject of negotiations between the social partners and fixed after agreement has been reached. The national minimum wage represents the basic level which is obligatory for all lower levels: in other words, minimum wages at branch and company level cannot be lower than the national minimum wage. The new tripartite social dialogue agreement of 2005 aimed at introducing recommendations on average wage increases at national level.

Wage negotiations at branch level are carried out on the same basis as at national level. The difference is that agreements must be by consensus. The main problem is the extension of these agreements over all firms in the branch. The Ministry of Labour and Social Policy, which is responsible, does this very rarely. In most cases the branch agreements apply only to the bargaining parties.

Collective bargaining in Bulgaria and particularly wage negotiations take place mainly at company level. An important feature of the issues negotiated at higher levels is that they do not have a direct impact on the wages contracted at company level.

There are no substantial differences in wage fixing mechanisms between different levels of negotiations. No recommendations are made about the wage fixing mechanism for all levels. Each party determines a wage level in accordance with their standpoint.

2.2 | Wage policy objectives

Wage policy during the transition can be divided into two periods. The first covers the mid-1990s and can be characterized as restrictive. The objectives of Government wage policy were: (i) to use wages as an anchor for damping inflation; (ii) to use the minimum wage as a tool for regulating public sector wages; (iii) to reduce inflationary pressure by means of a restrictive income policy; and (iv) to limit social benefits and other non-wage payments.

The first objective was realized by implementing a taxed based income policy (TIP) in state-owned enterprises. The second was accomplished by linking all public sector wages funded by the state budget to the minimum wage, based on a series of coefficients. The third objective was carried out through irregular and adequate indexation of the minimum wage. Under conditions of high inflation (50–80 per cent) the minimum wage was adjusted once or twice a year, below inflation. Many social benefits (unemployment benefits, child allowance, social pensions, school and university grants and so on) were tied to the minimum wage.

The effect of this policy was a dramatic fall in real wages (minimum and average), increased impoverishment, labour force fragmentation, a drastic fall in real consumption, the disconnection of wages and productivity and growth in the informal sector, among other things (see Tzanov and Vaughan-Whitehead, 1998).

A new minimum wage policy was implemented after 1997, with radically different objectives. They included the gradual recovery of the real minimum wage in relation to economic development, achieving a better linkage with productivity, improving the welfare situation of low paid workers and stimulation of the overall wage level. Thus the Government aims at influencing not only a limited number of workers but also the general structure of remuneration.

An additional objective was implemented by the “Pact on economic and social development in the Republic of Bulgaria up to 2009”. In relation to income policy the social partners are committed to: (i) annual bargaining at national level on a recommended index of wage increases, taking into account inflation, labour productivity growth, national economic competitiveness and changes in tax policy; (ii) annual bargaining on recommended increases in public sector wages; (iii) fixing the national minimum wage, taking into account the official poverty line and average wage; and (iv) extending branch minimum wage agreements to all firms in the branch.

These agreements introduce two new elements into the negotiation process: (i) a mechanism for minimum wage fixing; (ii) a recommended rate of average wage growth and a mechanism for its determination. The aim of the social partners is to improve the link between wages and economic development.

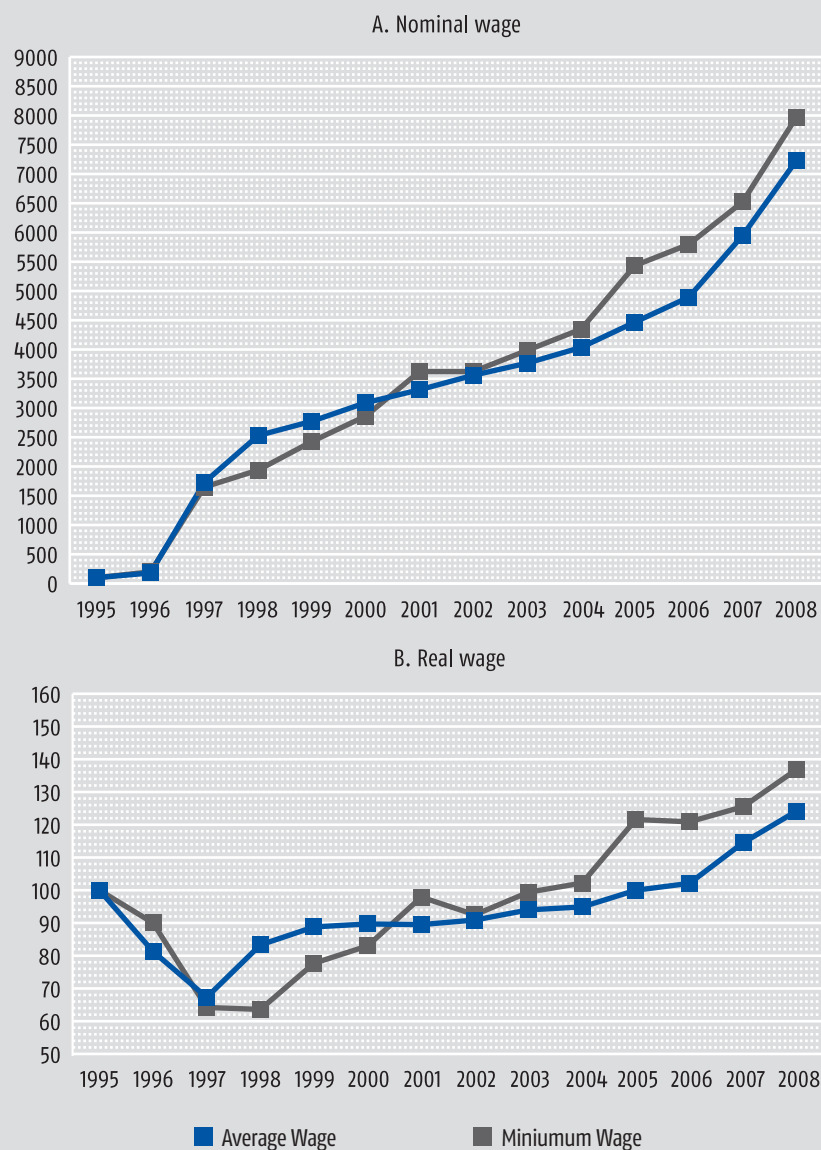
3 | Wage developments before the economic crisis

Wage development in Bulgaria is marked by two periods strongly corresponding to wage policy. The first (1990–97) is notable for the strong deterioration of all wages in real terms. The average real wage decreased by about 64.4 per cent, while the real minimum wage declined by as much as 88.7 per cent. The ratio between the minimum and the average wage experienced a downward trend, falling from 43.1 per cent in 1990 to 36.4 per cent in 1997.

The second period (1998–2008) is distinguished by prolonged wage progression in both nominal and real terms. Wage policy changed after the implementation of the currency board in 1997. The TIP was removed and replaced by wage controls only in large, monopolistic public companies (transport, energy and so on). This allows all wages to move in relation to economic performance without restrictions.

Changes in wage policy after 1997 led to considerable wage growth (Figure 6.1). The gross average wage increased nearly threefold in the period 1998–2008 (from 183 BGN in 1998 to 524 BGN in 2008), that is, by 49.2 per cent in real terms. The minimum wage also showed a substantial rise, experiencing a fourfold increase in nominal terms (from 54 BGN in 1998 to 220 BGN in 2008). This high nominal growth led to significant development in real terms. The real minimum wage went up by about 104.8 per cent. Since 2002, minimum wage growth has exceeded average wage dynamics, reducing the gap between them.

The periods of faster minimum wage growth do not match those of the average wage. The average wage increased more than the minimum wage in the period 1997–1999 and the changes in the latter could be seen as a process of adaptation to overall wage growth. In this sense, average wage development represents a condition for the minimum wage increase. Since 2002, the situation has changed. The state minimum wage has developed at higher rates than the average wage and the gap between them has closed.

**FIGURE 6.1 | AVERAGE AND MINIMUM WAGE DYNAMICS, BULGARIA, 1995–2008
(INDEX 1995=100)**

Source: National Statistical Institute (NSI), Ministry of Labour and Social Policy.

Progression of real wages may be observed in all economic sectors and branches, but to different extents. Four sectors show significant development. Real wages in the financial sector increased by about 65.9 per cent during 2000–2008. The real wages of public administration employees, teachers and health care workers increased in the same proportion. In the case of the latter two groups it is the result of special measures taken by the Government to increase their wages, which are relatively low.

Real wage development is lowest in agriculture, manufacturing, construction and hotels and restaurants. In agriculture and manufacturing they were raised by 25.5 per cent and 26.7 per cent, respectively, while in construction and in hotels and restaurants the increase is higher (28.9 per cent and 37.2 per cent, respectively). These sectors are dominated by small and medium-size private enterprises and the protection of workers is weak. Wages in these sectors are also relatively low.

The faster growth of the minimum wage in comparison to the average wage implies a significant change of their relationship (Table 6.1). The MW/AW ratio has increased and at the end of the period reached 45–46 per cent.

TABLE 6.1 | RATIO OF MINIMUM WAGE TO AVERAGE WAGE, BULGARIA, 1997–2008 (%)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Ratio MW/AW	36.4	29.2	33.3	35.3	41.7	38.8	40.3	41.0	46.3	45.1	41.8	42.0

Source: NSI. Ministry of Labour and Social Policy.

The minimum wage/average wage ratio is higher in low pay sectors (agriculture, manufacturing, construction, hotels and restaurants), in most of which it increased to over 50 per cent in 2008. Significant changes in the MW/AW ratio were observed in agriculture (18.7 percentage points), hotels and restaurants (17.3 percentage points), construction (15.1 percentage points) and manufacturing (14.6 percentage points). This indicates only a weak impact of minimum wages on average wage development in those branches. In the higher wage branches (mining and quarrying, financial intermediation and insurance) and in those which have experienced substantial wage increases (public administration, education and health care) the MW/AW ratio is lower. This relationship suggests a less important role for the minimum wage in these sectors.

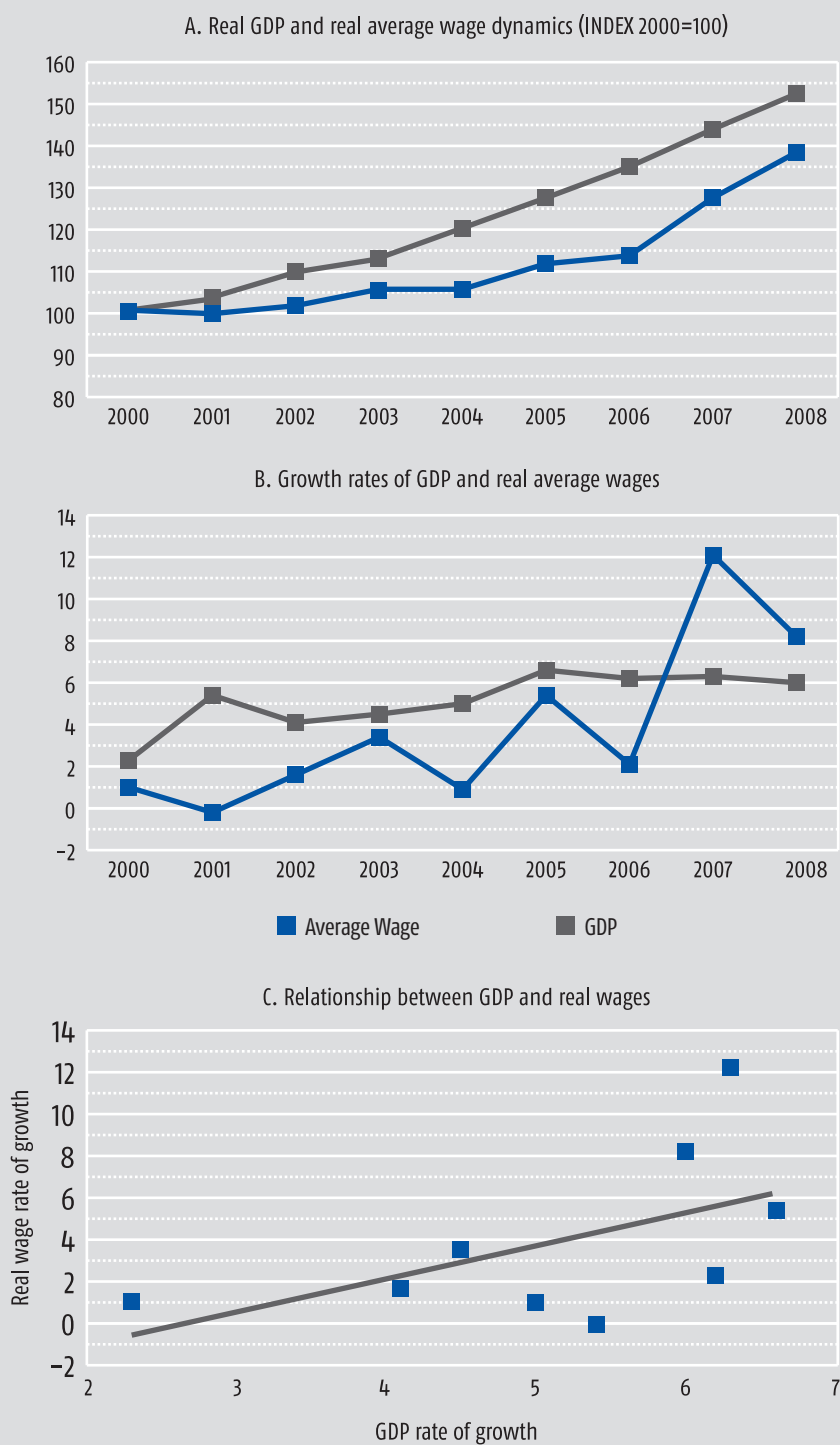
4 | Wage dynamics, economic development and wage disparities

4.1 Wage dynamics and economic development

As already mentioned, economic growth has an impact on wage development. A closer analysis of this relationship shows that it is fairly weak. Since 2000, GDP has increased more quickly than the real average wage: GDP grew by 52.3 per cent during 2000–2008, while the real average wage rose by 38.1 per cent (Figure 6.2, panel A). The gap between them widened up until 2006 (20 percentage points), before falling to 14 points over the next two years.

The other important feature of the relationship between GDP and wages is the relatively large difference between their rates of growth (Figure 6.2, panel B), with real wages growing much less than GDP throughout the period (with the exception of the past two years). The gap averages 1.2 percentage points. In addition, the higher fluctuation of wage growth suggests that the link between wages and economic performance is unstable.

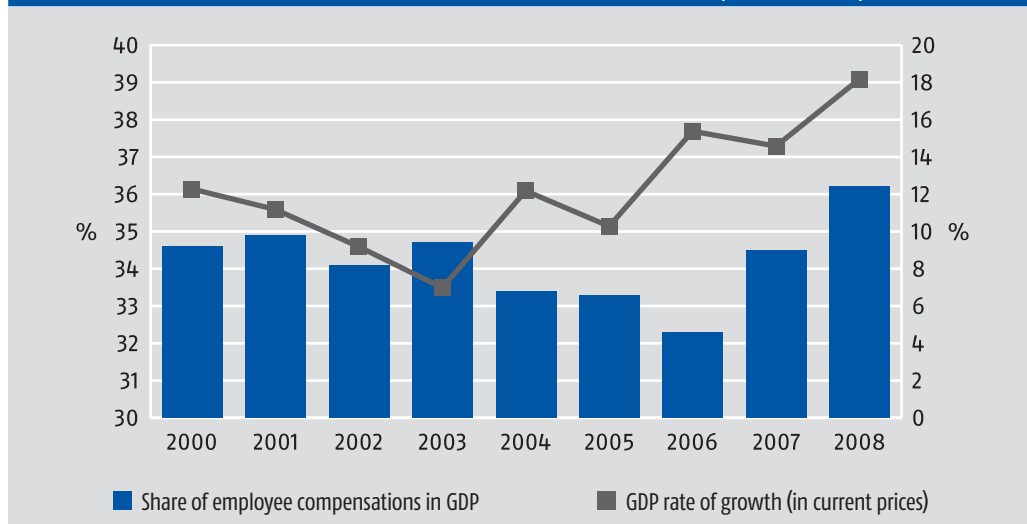
Despite the lower dynamics of real wages the relationship with GDP is positive. The link between GDP and real wage growth rates shows a positive relationship (Figure 6.2, panel C). This suggests a positive influence of GDP on real wages. However, this connection is not strong (the correlation coefficient is about 0.54).

FIGURE 6.2 | GDP AND REAL AVERAGE WAGES, BULGARIA, 2000–2008

Source: NSI.

The moderate impact of economic growth on wage dynamics is due to the relatively low share of employee remuneration in GDP (Figure 6.3). This share ranged between 32 and 36 per cent during 2000–2008 and shows contradictory development tendencies. It remained stable between 2000 and 2003, despite the downward trend of GDP growth (current prices). The reduction of the wage share (2003–06) does not correspond to the acceleration of GDP growth rates. In the past two years the wage share has increased significantly, while GDP rates have not changed so much.

FIGURE 6.3 | SHARE OF EMPLOYEE REMUNERATION IN GDP, BULGARIA, 2000–2008



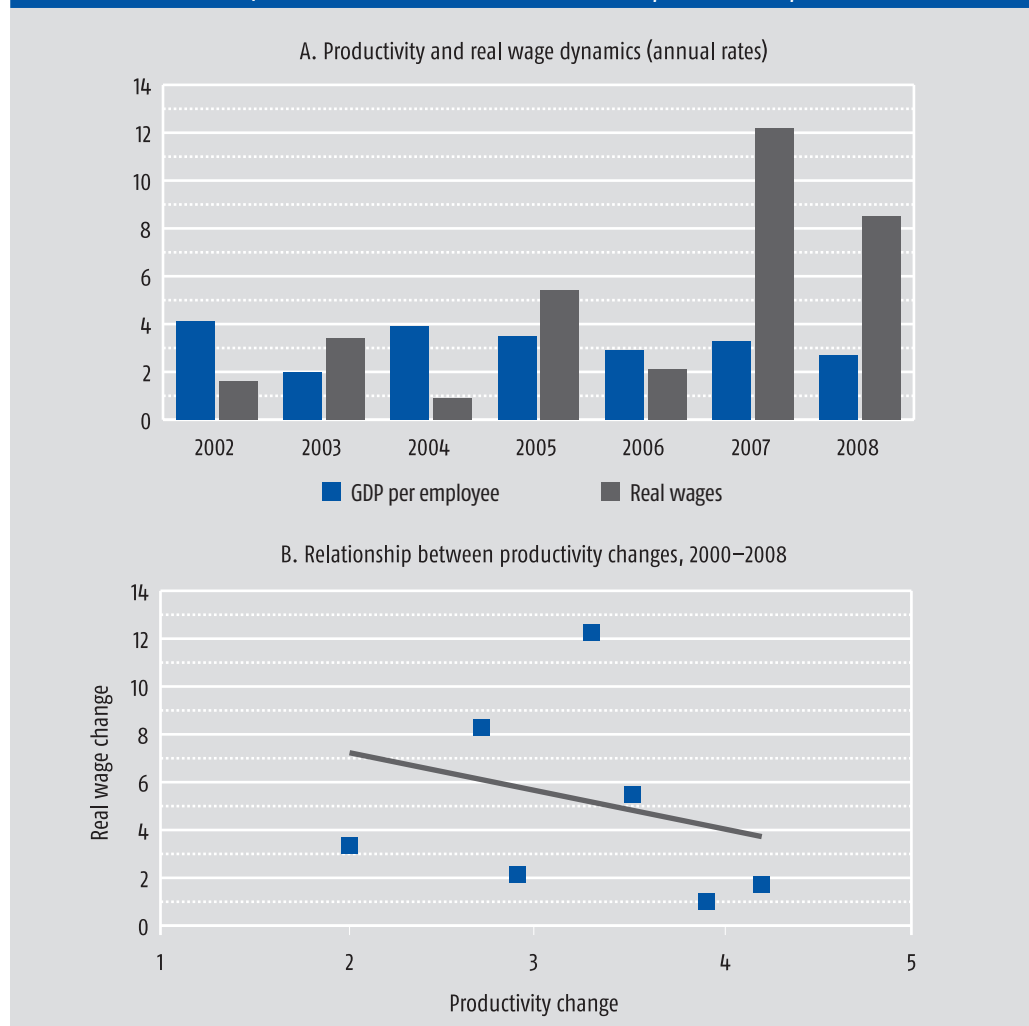
Source: Statistical Yearbook, NSI, selected years.

This development of the wage share may be explained by the weak connection of wages to economic results at enterprise level. During the period 2003–06 employee remuneration increased less than gross value added (32.8 per cent and 36.3 per cent, respectively). As a result, workers received a lower proportion of output. In the past two years, the situation has changed, with higher growth of employee compensation (51.1 per cent) and a lower increase in gross value added (35.9 per cent).

The moderate impact of economic development on wage dynamics is a consequence of the weak relationship with productivity. Real wage growth in most years during the period did not follow productivity, particularly after 2000 (Figure 4). Annual changes in real average wages differ significantly from productivity changes for all years during the period and especially in the past two years (Figure 4, panel A). During these two years real wages increased much more (12.1 per cent and 8.2 per cent, respectively) than productivity (3.3 per cent and 2.7 per cent, respectively). All this suggests a weak relationship between the two (Figure 6.4, panel B). The scatter diagram depicting changes in productivity and real wages shows considerable disparity in the linkages and no well defined trend. To some extent, the figures on wages and productivity for 2008 were influenced by the world financial and economic crisis. The effects of the crisis on the Bulgarian economy started appear in the second half of the year. The growth rates of GDP, productivity and real wages slowed down in comparison to 2007, but this did not change their relations.

Considerable disparity can be observed between the links between productivity and real wages at the sectoral and branch levels. In agriculture, productivity declined (−3.9 per cent) during 2001–08, while the real average wage grew by about 31.4 per cent. A similar picture may be observed in electricity, gas and water. There is positive real wage growth (6.3 per cent) as against negative productivity (−3.1 per cent) for the period 2000–2006. The real wages in the trade sector increased by 11.6 per cent, while productivity grew by 7.9 per cent. Higher differences between productivity and wage growth can be observed where productivity exceeds wage growth. For example, during the same period, productivity increased several times more than real wages in mining and quarrying, transport and manufacturing.

FIGURE 6.4 | PRODUCTIVITY AND REAL WAGES, BULGARIA, 2000–2008



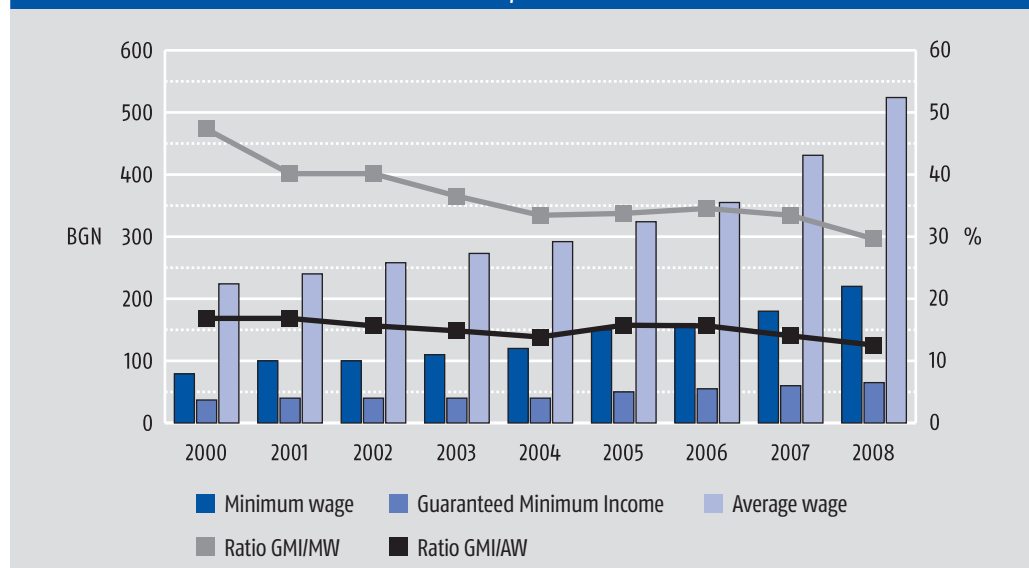
Source: Statistical Yearbook, NSI, selected years.

4.2 | Wage development and social protection

An important aspect of wage development is its relationship to the social protection system. The progression of social benefits should be in accordance with wage development (both minimum and average wages) if those on low incomes are to be adequately protected. The Bulgarian Government introduced an official poverty line¹ three years ago, but it is not used as an instrument of social assistance. Social protection of the poor is based on the Guaranteed Minimum Income (GMI). This is the basic income for determining social assistance payments. GMI is defined by the Government and adjusted to family size and composition via a system of coefficients. Eligibility for welfare benefits and their amount depend on the GMI and means testing.

The relationship between the GMI and wages (average and minimum wage) has experienced a downward trend since 2000 (Figure 6.5). The average and minimum wage increased more (more than twofold) than GMI (74.3 per cent). As a result, the gap between wages and GMI widened and the ratios went down. The ratio of the GMI to the minimum wage declined by 20.1 percentage points (from 47.2 per cent in 2000 to 27.1 per cent in 2008) and the GMI/AW ratio was reduced by about 4.3 points (from 16.7 per cent in 2000 to 12.4 per cent in 2008).

FIGURE 6.5 | WAGE AND GUARANTEED MINIMUM INCOME DEVELOPMENT, BULGARIA, 2000–2008



Source: NSI, Ministry of Labour and Social Policy.

The growing gap between social assistance payments and wages has a number of effects. First, social protection of the poor becomes weaker; second, it prevents workers from falling into the social

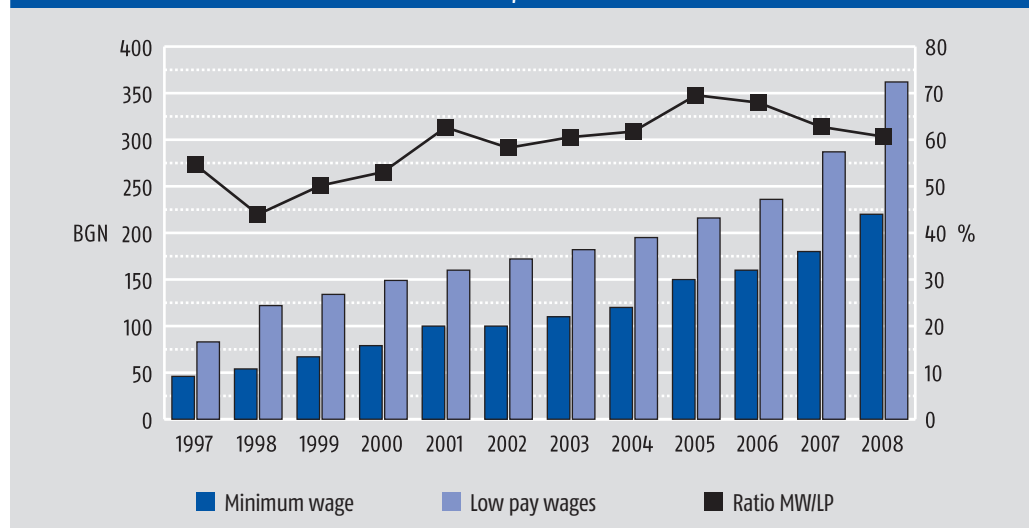
assistance net; and third, it encourages beneficiaries of working age to remain in the labour market. Older people in the social assistance system are better protected, receiving higher social benefits in relation to working age beneficiaries.

The impact of minimum wage development on low paid workers in Bulgaria is difficult to assess because of the lack of statistical information on wage distribution over the period as a whole. The possible effects could be analysed indirectly, using the dynamics of the ratio between minimum wages (MW) and low pay (LP), defined as two-thirds of the average wage (MW/LP ratio).

The trend of the MW/LP ratio shows a strong increase since 1998 (Figure 6.6). The faster growth of the minimum wage indicates a relatively low impact on changes in low pay levels. This means that there is a process of compression of the wage distribution from the bottom and therefore that the minimum wage offers more protection. The other argument for the existence of wage compression is the narrowing of the gap between low pay and average wages: the MW/LW ratio is much higher than the MW/AW ratio. From 2006, the pressure on the bottom began to relax and the gap in relation to low wages widened.

The minimum wage, as part of the social protection system, is supposed to prevent workers from falling into poverty. There is no official definition of the phenomenon “working poor”. In this analysis we will consider to be poor those workers whose incomes are below the poverty line. For this purpose an appropriate measure is the Laeken indicator, which calculates the risk of poverty in work.

FIGURE 6.6 | MINIMUM AND LOW WAGES AND THE RATIO BETWEEN THEM, BULGARIA, 1995–2008



Source: Author's calculations using NSI data.

The working poor in Bulgaria represent a relatively small part of all workers (Table 6.2). In dynamic terms, the trend is towards a decline in the percentage of working poor. There is no significant gender difference with regard to the working poor from 2001.

TABLE 6.2 | RATE OF THOSE AT RISK FROM POVERTY IN WORK, BULGARIA, 2001–2007 (%)

	Total	Men	Women
2001	7	–	7
2002	6	–	–
2003	7	6	8
2004	7	7	6
2005	6	6	6
2006	5	5	6
2007	6	6	6

Source: Eurostat.

Minimum wage development in Bulgaria has had a significant impact on reducing poverty among working people. The periods of poverty reduction match the periods of minimum wage increase. For example, the nominal minimum wage increased by 80 per cent in the period 2001–07 and poverty among workers fell by 1 percentage point.

4.3 | Wage disparity

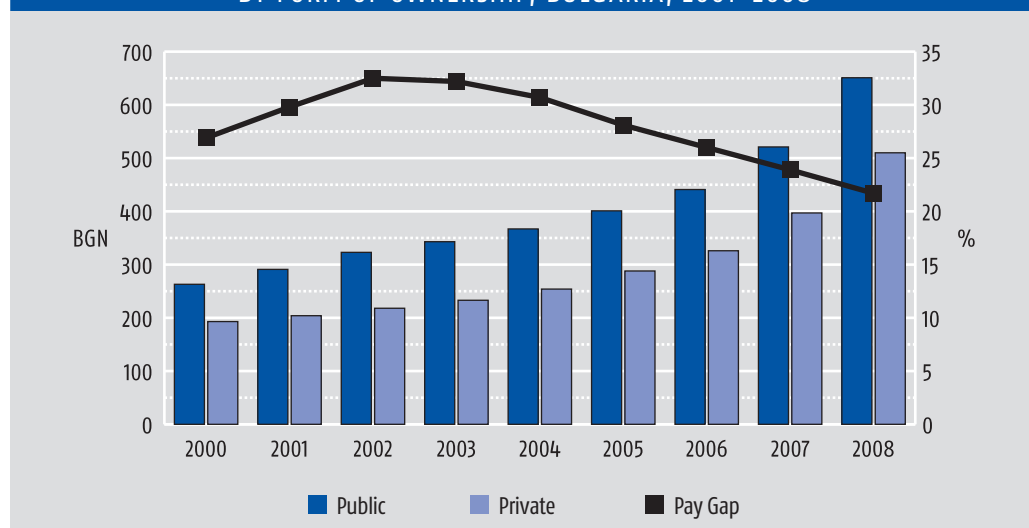
In the context of the impact of wage development on wage disparity in Bulgaria, four aspects are of particular importance: (i) wage differences by ownership (public and private sector); (ii) the differences between the highest and lowest income groups; (iii) relative wages by economic sectors and branches; and (iv) gender differences.

Based on official statistics, earnings in the public sector are higher than those in the private sector. This must be interpreted with caution, however, because the wage data coming from the private sector are not completely reliable. For example, in many firms there is a practice of declaring low wage levels but paying the workers additional sums “under the table”.

However, the wage disparity between the public and private sectors shows a downward tendency in the period 2001–08. The pay gap² by form of ownership fell from 29.8 per cent in 2001 to 26.7 per cent in 2008 (Figure 6.7). Only in 2002 and 2008 did wage differences increase.

² Calculated as a percentage difference between the average gross earnings of employees in the public and private sectors as a percentage of gross earnings in the public sector.

FIGURE 6.7 | AVERAGE WAGES IN PUBLIC AND PRIVATE SECTOR AND PAY GAP BY FORM OF OWNERSHIP, BULGARIA, 2001–2008



Source: NSI.

It is difficult to explain this process solely in terms of a wage increase in the private sector. Perhaps the transparency of the “shadow economy” has a role in this process. This conclusion is based on the reduction in labour taxation and the increase in minimum social insurance thresholds.

It was possible to analyse the changes in wage disparity in terms of income classes (between the lowest and the highest deciles) using statistical information for 2002 and 2006. The net earnings disparity between the lowest and highest deciles was relatively low in 2002. For all employees (full- and part-time) the ratio between the ninth and first deciles is 4.0. More or less the same difference applies to full-time employees (3.9), while there is an even lower disparity between part-time employees (3.4). As a result of the changes in minimum wage policy, the difference between the lowest and highest deciles declined in 2006. For all employees the ratio between the ninth and first deciles fell to 3.6, and for full- and part-time employees to 3.5 and 2.5, respectively. These results indicate that the minimum wage has an important role in lowering wage disparity. The faster growth of the minimum wage compressed the wage distribution from the bottom.

In parallel with the narrowing of the gap between the lowest and the highest wages wage disparity is also being reduced between economic sectors and branches. It has been more visible during the past few years as the minimum wage has increased significantly. The changes in the relative wage structure between economic sectors and branches are presented in Table 6.3. In the sectors financed by the budget (education, health care and public administration) wages increased above the average wage. In the other low pay branches (agriculture, manufacturing, construction, trade and hotels and restaurants) they remained below average, but the ratio to the average wage increased.

TABLE 6.3 | RELATIVE WAGES BY ECONOMIC SECTORS AND BRANCHES, BULGARIA, 2000–2008 (AS A PERCENTAGE OF THE AVERAGE WAGE)

Economic sector	2000	2001	2002	2003	2004	2005	2006	2007	2008
Agriculture, forestry and fishing	80.4	77.2	74.5	73.9	73.8	72.2	70.4	70.6	73.3
Mining and quarrying	164.0	162.2	161.8	157.5	166.3	161.5	163.7	171.2	166.8
Manufacturing	97.5	94.5	91.8	90.0	89.6	89.2	88.9	89.9	90.4
Electricity, gas and water supply	183.3	185.1	180.3	187.1	184.9	177.5	179.8	171.4	173.2
Construction	91.0	88.6	83.5	85.0	83.8	82.6	82.7	84.1	85.2
Trade and repair	70.2	69.8	70.0	73.6	74.3	77.4	79.6	81.3	74.0
Hotels and restaurants	62.3	62.5	60.0	59.4	58.8	62.5	61.7	67.6	62.0
Transport and communication	120.7	122.3	120.2	125.2	121.3	122.8	122.9	127.6	125.1
Financial intermediation and insurance	196.7	212.4	214.9	228.9	232.7	233.0	227.4	232.0	236.9
Real estate, renting	94.7	95.2	93.2	91.0	92.8	100.2	107.8	98.9	110.4
Public administration	135.7	140.0	153.2	158.0	160.8	147.7	147.3	147.8	145.8
Education	95.0	96.6	104.4	108.8	109.9	104.7	105.1	100.3	110.7
Health and social services	84.5	90.7	99.0	108.7	112.9	116.9	108.4	106.1	108.9

Source: NSI.

The opposite process is occurring in high pay sectors (mining and electricity). Earnings in these branches increased at a lower rate than average wages. Only in the financial sector did wages rise at a higher rate. The difference between the sectors with the highest and the lowest average wages declined from four times in 2003 to 3.8 times in 2008.

4.4 | Gender equality

The Bulgarian Government has taken a number of legislative, institutional and practical steps to ensure the equal treatment of men and women. The legal framework with regard to gender equality includes a number of laws aimed at providing protection from gender discrimination (Labour Code, the Protection against Discrimination Act, the Health and Safety at Work Act, the Countering Human Trafficking Act and so on). In these laws, particular attention is paid to equal pay (Equal Remuneration Convention, 1951 – No. 100). A new section (243) was introduced in the Labour Code (Decree No. 44 of 12 March 2001) which provides for equal remuneration for men and women for the “same and equivalent work” – in other words, equal remuneration for work of equal value. Also, under section 14(1) of the Protection against Discrimination Act (2003), the employer is obliged to ensure equal remuneration for equal work. This principle applies to all remuneration, paid directly or indirectly, in cash or in kind.

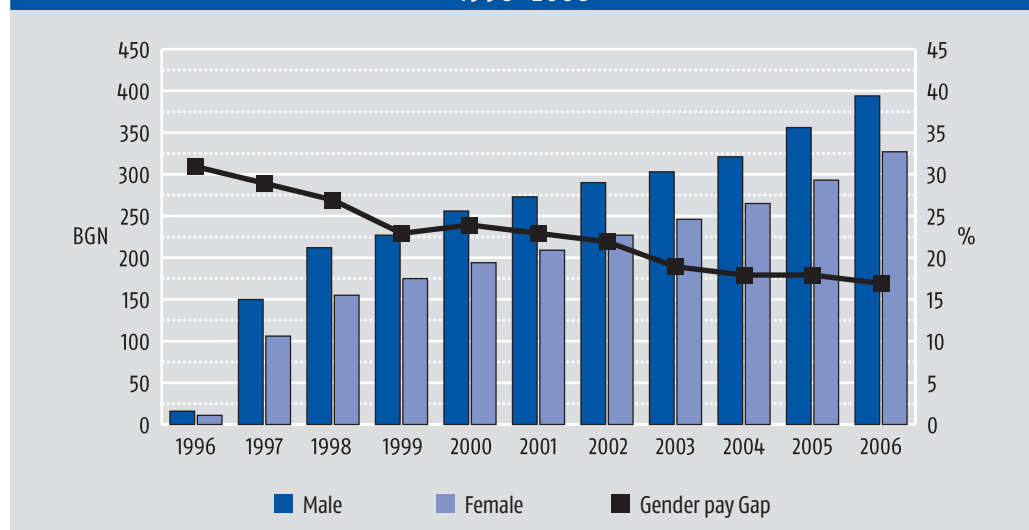
The Committee of Experts on the Application of Conventions and Recommendations (CEACR) submitted a number of comments and requests (during 2006–09) on implementation. In respect of equal remuneration, the Committee requested a more detailed explanation of the statistical data on the increase in the gender pay gap in the public sector in 2005 and more information on the objectivity of job evaluations in terms of gender-neutral assessments and classifications.

The amount and structure of wages in Bulgaria are determined on the basis of job evaluation and position in the enterprise or organization (Decree No. 4 of 17 January 2007). Evaluation procedures are gender-neutral and based on the following criteria: (i) the complexity of the work in the work place; (ii) the level of responsibility; (iii) the difficulty of the work; and (iv) the nature of the working environment. This rule is obligatory for all firms, regardless of form of ownership, branch affiliation and so on.

The gender pay gap in the public sector increased between 2004 and 2005 from 20.1 per cent to 23.1 per cent, while in the private sector it decreased from 21.3 per cent to 20.6 per cent. It is difficult to explain this difference in the present study because of the lack of detailed statistical information. However, there was a downward tendency in the gender pay gap between 2002 and 2006 in both the public and the private sector. Based on wage survey information from 2002 and 2006, the gender pay gap in the public sector decreased from 29.1 per cent in 2002 to 19 per cent in 2006. During the same period, the gender pay gap in the private sector also declined, from 19.1 per cent in 2002 to 16.8 per cent in 2006. The more rapid reduction of gender wage disparities in the public sector could be explained by the government measures to appoint women to higher-ranking positions.

The overall pay differences between men and women are marked by a declining tendency (Figure 6.8). Differences between the wages of men and women fell during the period 1996–2006. The gender pay gap³ decreased to almost half (from 31 per cent in 1996 to 17 per cent in 2006).

FIGURE 6.8 | GENDER WAGE DIFFERENCES AND GENDER PAY GAP, BULGARIA, 1996–2006



Source: NSI.

3 Calculated as the percentage difference between the average gross earnings of male and female employees as a percentage of male gross earnings.

The minimum wage is important for the reduction of gender pay disparities. The percentage of women below the minimum wage was 1.3 per cent, in contrast to 0.6 per cent of men in 2002. Also, 42.6 per cent of women are low paid, while for men this percentage is 37.4 per cent. There is no comparable information for evaluating the impact of the minimum wage on gender wage disparities, but gender pay gap dynamics indicate a strong link.

In contrast to the reduction of the wage disparity between men and women gender differences with regard to other labour market parameters remained unchanged or deteriorated. Women's employment rate increased from 46.3 per cent in 2000 to 59.5 per cent in 2008, while men's employment rate rose by an even higher proportion (from 54.7 per cent in 2000 to 68.5 per cent in 2008). As a result, the difference between male and female employment rates has increased slightly over the past few years. The situation with regard to unemployment is different. From 2000, female unemployment rates were lower than those of males, but over the past three years they have equalized. This is a result of the restructuring of branches with higher male employment rates (manufacturing, mining and so on).

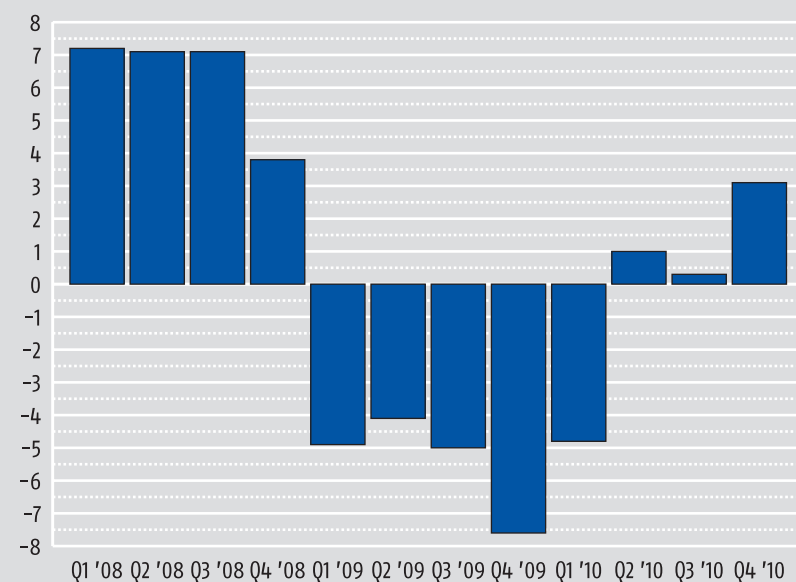
5 | The Bulgarian economy in the context of the economic crisis

5.1 | Sharp decrease in economic activity in 2009

The impact of the world financial and economic crisis on the Bulgarian economy began to be felt after the third quarter of 2008. In the fourth quarter of 2008 GDP growth slowed down, but remained positive (Figure 6.9). Compared to the first quarter of the year, GDP growth diminished by 3.5 percentage points. For this reason, 2008 could be treated as a year of slower growth rather than one of economic crisis.

The Bulgarian economy entered into recession at the beginning of 2009. The recession continued to worsen throughout the year (Figure 6.9). GDP contracted significantly, quarter by quarter, at an accelerating rate. According to preliminary statistical data for 2009, GDP fell by 5.1 per cent. The reasons for this considerable deterioration are complex but the shrinkage of external demand for Bulgarian goods is the most important. This had a strong negative effect on investment, the decline of which contributed to a decrease in domestic demand.

FIGURE 6.9 | GDP GROWTH, BULGARIA, 2008–2010 (%)



Source: NSI.

The economic crisis hit industry (mainly manufacturing) and construction hard. Total industrial output in December 2009 declined by 12.1 per cent in comparison to the same month in 2008. During this period manufacturing output decreased by 14.3 per cent. Among manufacturing branches, the crisis had a significant impact on the furniture industry (–35.7 per cent), machinery (–27.6 per cent), textiles (–24.5 per cent) and clothing (–19.5 per cent) in particular. Output in construction fell by more than that of industry, tumbling 15.3 per cent for the period January–December 2009 in comparison to the same period in 2008. Services also shrank, but to a lesser extent.

The economic downturn contributed to the deterioration of the balance of payments in 2009. State revenues declined, in response to which the Government decided to reduce public spending. Nevertheless, in 2009 there was a budget deficit for the first time in recent years, amounting to 2,569.9 million BGN (–3.9 per cent of GDP). This put Bulgaria among the countries with the smallest budget deficits in the EU.

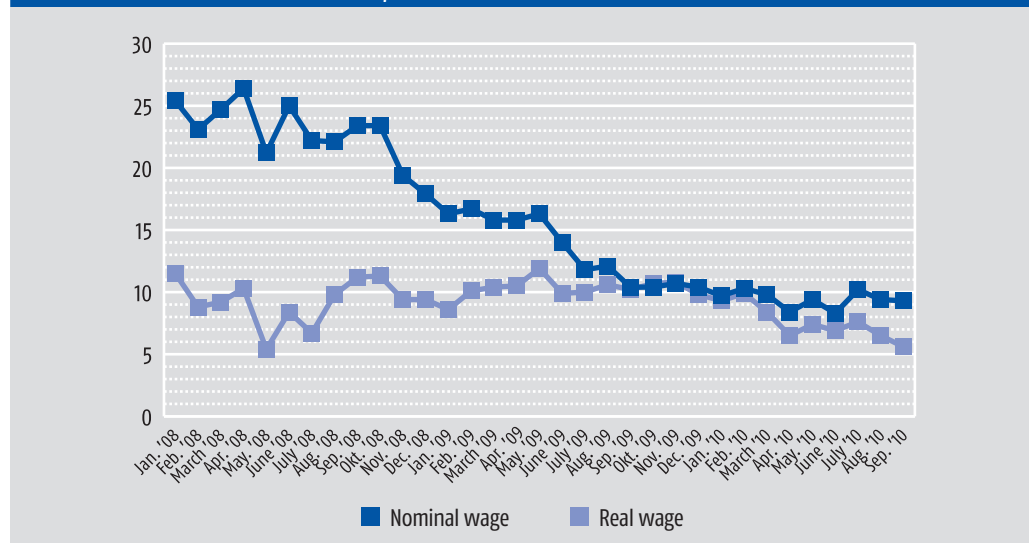
The economic situation started to improve from the second quarter of 2010. The GDP has slightly increased after 5 quarters of decline. Industrial output started to grow from the last months of 2009 and during the period September 2009–September 2010 increased by 8.2 per cent. During the same period manufacturing output increased by 10.3 per cent, while the output in construction dropped by 12.3 per cent. Bulgarian exports also registered significant growth. During the period January–September 2010 exports increased by 32.9 per cent (23.6 per cent to EU countries) compared to the same period of 2009. This positive economic development suggests that Bulgaria is exiting the recession and entering a period of economic recovery.

5.2 | Impact of the crisis on wage development

The influence of the economic crisis on the various kinds of income in Bulgaria (including wages) has been diverse. On the one hand, the deterioration of economic output and labour market indicators (declining employment and rising unemployment) has had a negative impact on income development, but on the other hand, this negative influence has been compensated to some extent by the fall in inflation caused by the crisis. As a result, the development of incomes overall has not been affected so much.

Monthly wage data show that the effect of the crisis was not dramatic in 2009. There was positive growth in both nominal and real earnings (Figure 6.10), but with decreasing nominal wage rates. The average nominal wage increased by about 8.4 per cent in 2009 in comparison to 26.5 per cent in 2008. Monthly nominal wage rates started to decline in October 2008 and continued to fall in 2009, losing about 7 percentage points in 2009 (from 17.9 per cent in December 2008 to 10.4 per cent in December 2009). Nominal wage rates continued to fall in 2010. For the first nine months of 2010 all monthly growth rates were below 10 per cent.

FIGURE 6.10 | NOMINAL AND REAL WAGE DYNAMICS (RATE OF GROWTH), BULGARIA, JANUARY 2008–SEPTEMBER 2010



Source: NSI.

In contrast to nominal wage dynamics, real earnings show a fairly stable development during 2009. The average monthly growth rate in 2009 is about 9.5 per cent, with minor fluctuations. This is due to the low inflation during the year. The inflation rate tumbled from 7.8 per cent in 2008 to 0.6 per cent in 2009.⁴ This considerable reduction in inflation as a result of the crisis provides some compensation for

4

Compared to the end of the previous year.

the falling nominal wage growth. The trend of real wages changed in 2010. Real monthly wage rates declined from 9.2 per cent in January to 5.6 per cent in September.

The impact of the crisis on wage trends at branch level is different. In most of them it is expressed in a slowdown of growth rates in both nominal and real terms. Even in the most affected branches wages have increased. In manufacturing, nominal wages rose, but at a diminishing rate (from 11 per cent in the first quarter to 8.8 per cent in the fourth quarter of 2009). However, in real terms they increased at an increasing rate (5.6 per cent in first quarter and 7.9 per cent in the fourth quarter). A similar trend is observed in construction. Nominal wage growth fell from 23.7 per cent to 20.6 per cent between the first and last quarters of the year, while real wages increased (from 17.7 per cent to 19.6 per cent). In low pay branches (agriculture, trade and hotels and restaurants), which are less affected by the crisis, wage development followed the pattern of decreasing nominal growth rates and stable real wage rates.

Wage dynamics in the public sector (public administration, education and health care) are distinguished by a higher growth deceleration, particularly from the second half of 2009. This is a consequence of the restrictive wage policy launched by the Government in the middle of the year. The Government abolished the foreseen wage increase in these sectors. As a result, nominal and real wage growth rates declined considerably. Nominal wages in education increased by 21.7 per cent in the first quarter but in the last quarter they rose by only 8 per cent. Real wage rates fell from 15.8 per cent to 7.1 per cent over the same period. The same wage dynamics trend is observed in the health sector.

The restrictions on public sector wages affected the wages of public administrative employees even more. The positive growth of the first three quarters of 2009 was strongly reduced and in the fourth quarter turned negative. Nominal and real wages in the fourth quarter fell by 2.7 per cent and 3.5 per cent, respectively, in comparison to the same period in the year before the crisis.

Minimum wage development in 2009 was also positive. The national minimum wage in 2009 was fixed at 240 BGN, which represents a 9.1 per cent increase on 2008. In real terms, the minimum wage rose by 6.1 per cent. In view of the fact that the minimum wage rose less than the average wage the ratio between them declined in comparison to 2008, falling from 42 per cent in 2008 to 40.6 per cent in 2009. This reduced the protective power of the minimum wage.

The development of the minimum and average wages during 2009 also increased the gap between the minimum and low pay thresholds. The ratio between them declined from 63.9 per cent in the first quarter of 2009 to 59.4 per cent at the end of the year. On average, the ratio was 60.9 per cent, however, which is close to the figure in the year before the crisis (60.4 per cent).

5.3 | Economic crisis and wage disparity

Restrictions on public sector wages introduced by the Government in 2009 to address the crisis have had some influence on wage disparity. From the available statistical information this impact can be analysed in two ways: wage differences between the public and private sectors and wage disparity by economic sector or branch.

Wage dynamics in the public and private sector differed significantly in 2009 and 2010 (Table 6.4). Wages in the public sector increased, at a declining rate, throughout the year of the crisis. This was more evident after the imposition of public sector wage restrictions. Wages in the private sector developed at

more stable and positive rates. Despite this, the economic crisis led to a downward trend in growth rates. In contrast to the public sector, growth rates in the private sector declined insignificantly (3 percentage points).

TABLE 6.4 | GROWTH RATES OF NOMINAL WAGES BY FORM OF OWNERSHIP, BULGARIA, 2009–2010 (PREVIOUS PERIOD = 100; %)

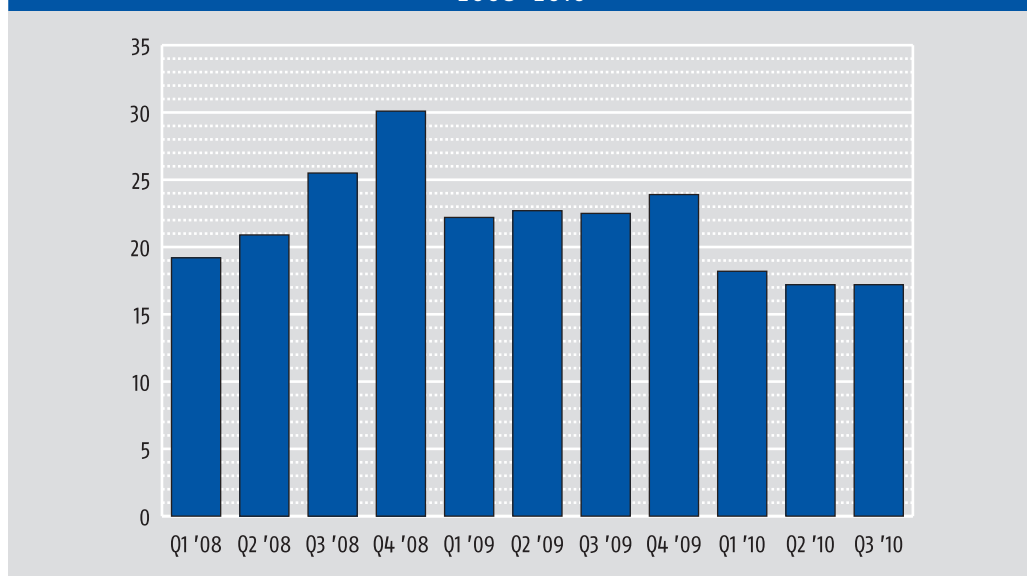
	2009				2010		
	I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Public sector	19.4	16.9	8.0	10.4	6.1	3.7	4.7
Private sector	14.9	14.3	12.5	14.7	11.5	11.0	11.8

Source: NSI.

This difference between wage dynamics in the public and private sectors reflects wage development in real terms. Most affected by the crisis are public sector workers. Real wages in the public sector increased at diminishing rates (from 13.6 per cent in the first quarter to 3.1 per cent in the fourth quarter), while in the private sector they grew (from 9.4 per cent in the first quarter to 12.2 per cent in the fourth quarter).

As a result of the economic crisis the difference between public and private sector wages declined in 2009 and 2010. The wage gap calculated on the quarterly data for 2008–2010 clearly illustrates this (Figure 6.11). During 2008, the wage gap increased significantly, reaching over 30 per cent by the end of the year, while in 2009 it remained fairly stable. On average, the difference between public and private sector wages fell by 3.9 percentage points to 22.8 per cent. The wage gap between the public and the private sector continued to decline in 2010, reaching 17.2 per cent in the third quarter.

FIGURE 6.11 | WAGE GAP BETWEEN PUBLIC AND PRIVATE SECTOR, BULGARIA, 2008–2010



Source: NSI.

Besides the effect on the public and private sector pay gap the economic crisis has affected relative wages by economic sector and branch (Table 6.5). Wages in the public sector (public administration, education, health care and social services) fell back in comparison to 2008. The same effect is observed in higher pay sectors (financial intermediation and insurance, mining and quarrying, transport and communication). In low pay branches (construction, trade, agriculture and hotels and restaurants) wages remained below the average wage and in some of them the relative position worsened. For example, wages in manufacturing increased less than the average wage.

TABLE 6.5 | RELATIVE WAGES BY ECONOMIC SECTOR AND BRANCH, BULGARIA, 2008–2010 (AS A PERCENTAGE OF THE AVERAGE WAGE)

Economic branch	2008	2009				2010		
		I quarter	II quarter	III quarter	IV quarter	I quarter	II quarter	III quarter
Agriculture, forestry and fishing	73.3	76.0	75.9	78.4	75.4	71.9	73.8	79.8
Mining and quarrying	166.8	156.5	156.0	153.2	167.5	159.5	160.0	160.5
Manufacturing	90.4	88.1	87.8	89.2	87.3	87.4	87.8	89.3
Construction	85.2	90.9	94.2	95.4	92.6	86.6	90.5	90.8
Trade and repair	74.0	81.2	78.7	78.9	77.1	77.4	76.3	77.0
Hotels and restaurants	62.0	65.7	65.8	65.5	63.7	67.0	66.4	66.1
Transport and communication	125.1	116.5	111.4	110.5	109.4	109.7	108.6	113.5
Financial intermediation and insurance	236.9	210.7	230.4	204.3	218.5	210.3	221.6	202.8
Real estate, renting	110.4	106.2	108.3	107.4	112.4	114.4	118.1	114.4
Public administration	145.8	130.4	137.2	131.7	132.3	128.8	126.7	128.1
Education	110.7	105.5	107.0	111.3	113.2	104.5	105.5	105.5
Health care and social services	108.9	113.1	112.6	112.0	113.9	108.6	108.3	105.0

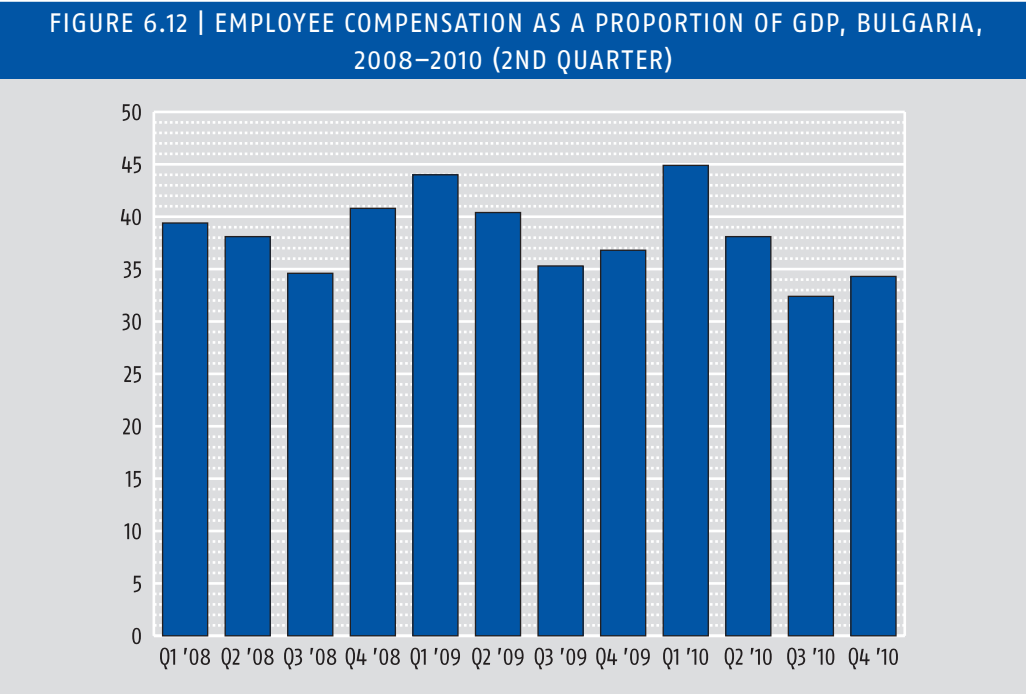
Source: NSI.

Despite the different wage developments among economic branches, as a result of the crisis the difference between the highest and lowest pay branches fell, declining from 3.8 times in 2008 to 3.4 times in 2009 and to 3.2 times in the third quarter of 2010. Also, the variation in branch wages fell from 0.41 in 2008 to 0.39 in 2009.

It is difficult to analyse the impact of the crisis on the relationship between wages and other social payments protecting the poor and older people because statistical information is lacking for 2009. Based on household survey data, however, the dynamics of real household incomes from social transfers (pensions, unemployment benefits and social assistance) is fairly heterogeneous. Household income per person from pensions increased in real terms by 21.3 per cent for the period December 2008–December 2009. Incomes from unemployment benefits and social assistance rose in nominal and real terms at a higher rate than pensions during the year.

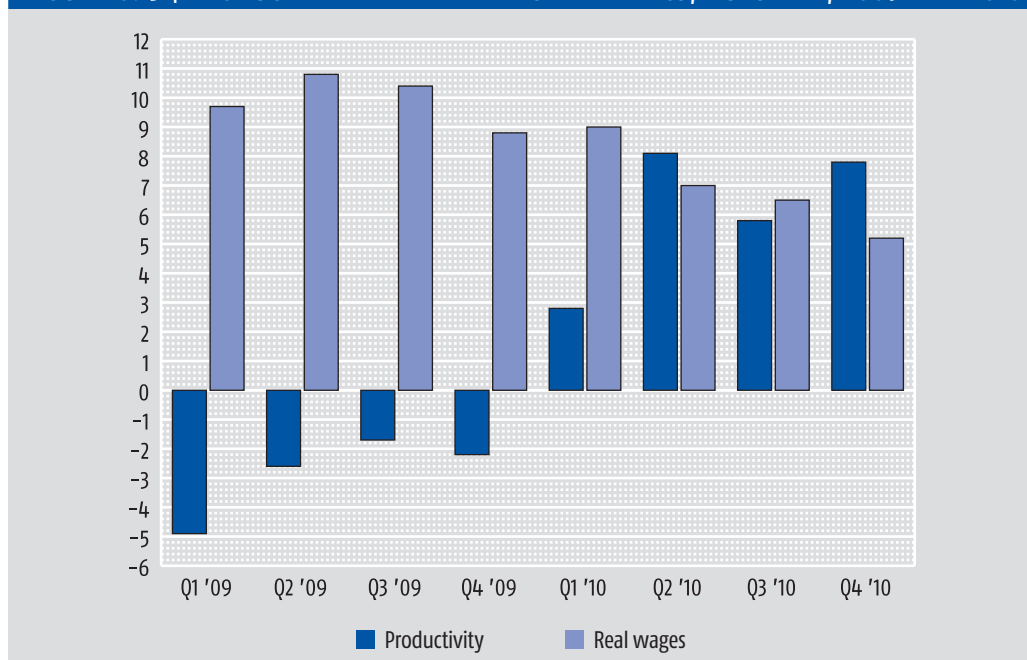
5.4 | Wages and economic development

The positive trends in wages in contrast to the contraction in economic output during the crisis contributed to an increase in the wage share (employee compensation as a proportion of GDP) (Figure 6.12). Quarterly changes in wage share showed a growing tendency in 2009 and 2010. In the first quarter of 2009 the wage share grew by 5.4 percentage points, while in the same quarter of 2010 growth was 0.9 percentage points. Similar positive growth was observed in all quarters of 2009 and 2010. On average, the wage share in 2009 increased by 1.7 percentage points. The increase in the wage share cannot be interpreted as an improvement in the linkage between earnings and economic performance.



Source: NSI.

Evidence for this conclusion is provided by the total disconnection of real wage dynamics from productivity changes during 2009 (Figure 6.13).

FIGURE 6.13 | PRODUCTIVITY AND REAL WAGE DYNAMICS, BULGARIA, 2009 AND 2010

Source: NSI.

As a result of the crisis, productivity⁵ in all quarters of 2009 fell in comparison to the same period in 2008, while real wages increased by over 10 per cent. This is due to many reasons, one of which is the desire to maintain both jobs and wages. Employment declined to a lesser extent than GDP (in the respective quarters by -0.3 per cent, -1.8 per cent, -3.7 per cent and -5.6 per cent), while wages grew. This wage increase does not correspond to the employment reduction, so that there is no trade-off between them in a strict sense. Generally, this situation indicates low economic efficiency and low competitiveness. The relationship between wages and productivity started to improve at the beginning of 2010. Productivity increased significantly due to the further reduction of employment, while real wage rates decreased.

6 | Wage policy reactions

The economic crisis in Bulgaria has strongly affected economic output, the labour market, foreign trade and public finances, but wage development only to a lesser extent. In these circumstances, the Government implemented a package of measures aimed at reducing the negative effects and stimulating economic development. Most of the measures are designed to balance the budget and tackle the expected budget deficit. In this context, the measures could be characterized as restrictive. Government

5

Measured as GDP per employee.

spending was cut to the bone. In light of these budget restrictions, the Government changed its wage policy, imposing restrictions on wage growth in the public sector.

The measures on wages were as follows:

- envisaged rises in nominal public sector wages (public administration, teachers, doctors and so on) from July 2009 were cancelled;
- the minimum wage was frozen until mid-2010;
- public sector wages were frozen until mid-2010.

The first measure was applied in order to reduce government expenditure for 2009. The wages of employees in those sectors will remain at their 2008 level. The effects on workers include the deceleration of wage increases in the public sector, but in some branches (public administration and science) wages declined in nominal and real terms from the second half of 2009. The next two measures are aimed at limiting labour cost increases via social insurance contributions. The Government introduced them in order to stimulate economic activity and preserve employment. The expected effects on wage development could be summarized as follows. First, the minimum wage and wages in the public sector will decline in real terms. This will affect a considerable part (almost one-third) of employment. Second, the minimum wage freeze will be reflected in a decline in the minimum wage/average wage ratio and the minimum wage/low wage ratio, indicating a diminution in the social protection of workers receiving the minimum wage. Third, the wage gap between the public and private sectors will narrow, but not as a result of wage increases in the private sector or shrinkage of the "shadow economy". Fourth, the decreasing purchasing power of the earnings of a sizable number of employees will reduce consumption and total domestic demand, which is highly undesirable in crisis conditions.

These restrictions have a temporary character. Their continued implementation after expiry depends on the prevailing economic situation. If economic growth returns they will be removed and wages should be raised.

The social partners differ significantly on the necessity and efficiency of the restrictive wage policy. The trade unions are opposed to the wage freeze, particularly with regard to the minimum wage. Their arguments are as follows: first, the minimum wage does not have a major influence on the growth of other wages; second, the wage freeze will reduce real wages and, as a consequence, domestic demand will fall further; and third, the expected positive effect on employment is questionable because it is not confirmed by previous experience with reducing social security contributions. The employers take the opposite view. They welcomed these restrictions, arguing that the minimum wage is too high, given the current crisis, and that in this way they will be able to maintain employment.

7 | Conclusions and policy issues

1. The changes in wage policy instituted in 1997 contributed to significant wage progression. Wage catch-up was observed in all sectors and branches, albeit to different extents. Wages in agriculture, trade, manufacturing and hotels and restaurants are below the average wage. Despite the progress

made towards more decent wages, further improvement remains a serious challenge for wage policy, particularly with regard to low paid workers.

2. Due to the active wage policy applied over the past few years the minimum wage/average wage ratio and the relationship between wages and the GMI have changed significantly. The faster growth of the minimum wage has, on the one hand, reduced the gap with the average wage, but on the other, increased the distance from the income threshold used as a basis for social benefits. This has turned social benefits into mere token payments. A great challenge for income policy is to set social benefits much closer to the official poverty line.

3. The linkage between wages and economic growth is weak. The wage share is relatively low and has exhibited a falling trend in recent years. This is mainly due to the relatively weak connection between wages and productivity. Wage policy should be improved to ensure a stronger connection with economic results. The social partners would like to change the existing wage fixing mechanism and bind it to productivity, inflation, competitiveness and taxation policy.

4. Wage inequality in Bulgaria is relatively low. The trend with regard to wage disparities between branches, men and women, and income classes is downwards. Generally, most workers in the low pay sectors are not covered by collective bargaining. Also, most collective agreements are not extended to non-signatory firms. The effectiveness of social dialogue should therefore be improved.

5. Bulgarian legislation and institutions ensure adequate equality of opportunity and treatment. Gender disparities in the labour market show different degrees of development. Wage inequality between men and women has fallen significantly, but the employment and unemployment situations of women should be improved. This requires better targeting of labour market policy.

6. The economic crisis has not had a major effect on wage dynamics. The effects may be observed in the deceleration of growth rates in nominal and real wages. The crisis has affected wage development at sectoral and branch level to differing extents. Even in the most affected branches (manufacturing and construction) positive wage growth has been observed, but at the expense of a higher reduction of employment (construction).

7. The impact of the crisis and wage restrictions on wage disparity is weak. Wage differentials between the lowest and highest pay branches have declined. Also, the pay gap between the public and private sectors has decreased as a consequence of the wage restrictions imposed on the public sector.

8. The relationship between wage dynamics and economic growth did not improve during the crisis year. The wage share increased temporarily due to wage inertia, returning to its initial position at the end of the year. The linkage between wages and productivity is broken. Productivity declined, while real wages increased.

9. The early transition years illustrated the ineffectiveness of a restrictive wage policy, but it made a comeback as a result of the crisis. This may have adverse social and economic effects. Wage restrictions may have a negative effect on real incomes and domestic demand. Freezing wages in order to reduce labour costs and public spending may reverse wage development. This situation is undesirable in the present crisis.

10. To avoid a reduction of domestic demand wage policy should be constructed in a way that protects real earnings from falling. This requires the introduction of measures to ensure their increase in accordance with expected inflation, budget revenues and economic performance. In this way, real wages should be maintained at the previous level and have a positive effect on consumer demand.

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The Impact of the Crisis on Wages in selected EU Member States

7 Wage effects of the financial and economic crisis – the case of Hungary

JÁNOS KÖLLŐ AND BEÁTA NACSA

This case study provides a preliminary report on wage developments in Hungary in response to the financial and economic crisis. Section 1 summarizes the literature on wage setting institutions; Section 2 discusses the evolution of real wages and wage inequalities prior to the crisis; and Section 3 examines the period of the crisis. The analysis is based on data covering a panel of more than 5,000 enterprises observed in May 2008 and May 2009 within the framework of the annual Wage Survey of the Office of Employment and Social Affairs (WS).

1 | Wage-setting institutions

From the start of the transition, Hungary developed a comprehensive system of collective wage bargaining, ranging from formal enterprise-level and sectoral-level agreements to national tripartite negotiations. Relatively little is known about the significance of these institutions but most observers agree that they seem more important than they really are: despite the existence of a full range of bargaining levels, relatively few workers are covered by collective agreements and the estimated union wage effects are rather modest. There is general agreement that the majority of high-wage firms have

full discretion over the level of earnings but low-wage ones are constrained by an increasingly pervasive system of minimum wage regulation and minimum wage taxation.

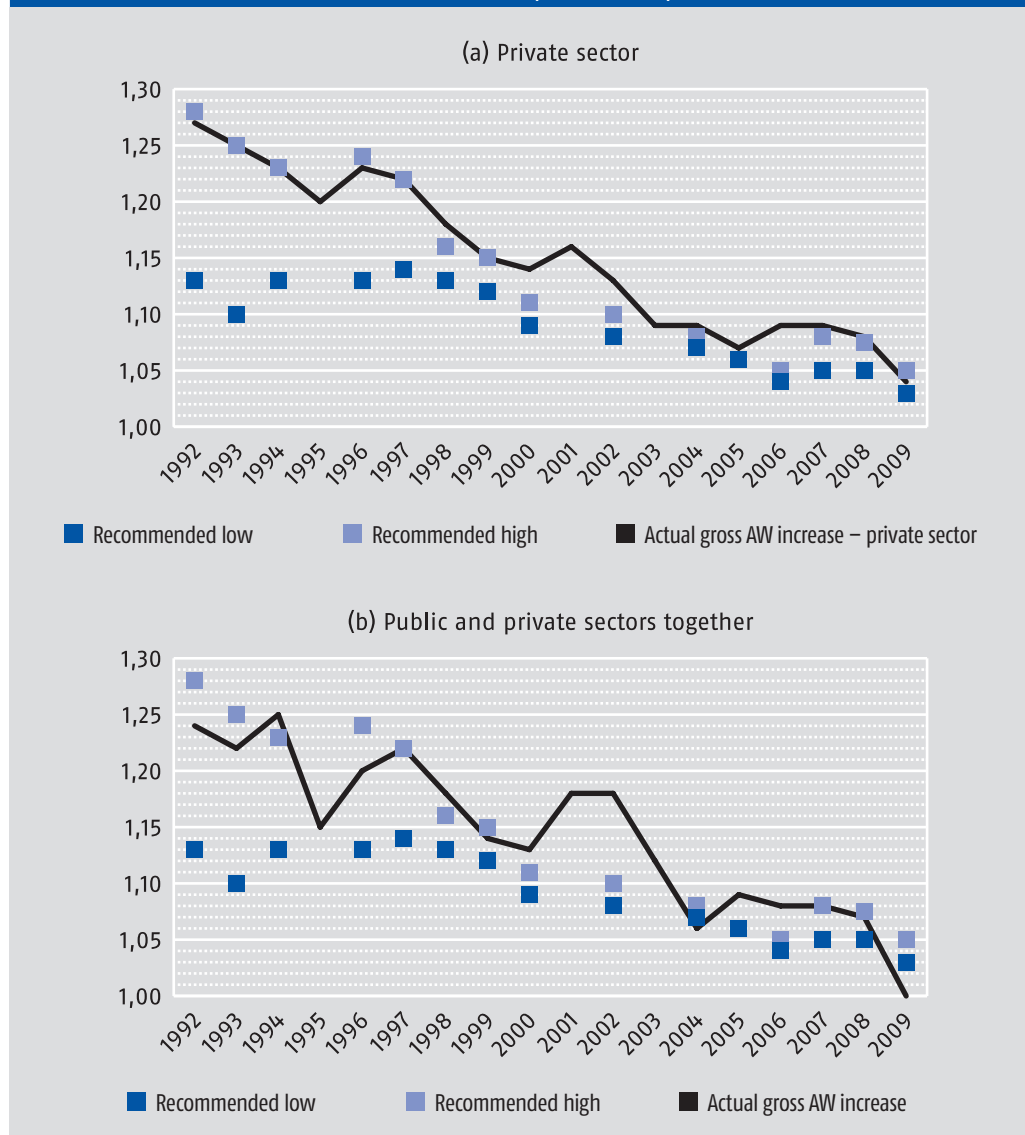
A *national tripartite Interest Reconciliation Council (Érdekegyeztető Tanács, ET)* has been in place since 1992.¹ Apart from negotiating the minimum wage (discussed later), the Council also formulates recommendations on annual average wage growth. In most years since 1992, the Council has proposed minimum and maximum benchmarks, but in some years (2003, 2005) only a minimum was recommended, and in two years (1995, 2001) the negotiations failed.²

No empirical research has so far been carried out on how the negotiated benchmarks affect the behaviour of firms and lower-level unions. The detailed overviews of wage bargaining practices in Ladó and Tóth (2001), Koltay (2003), Fazekas and Koltay (2006), Köllő and Nacsá (2007) and elsewhere have so far failed to provide hard evidence either supporting or refuting the claim that the central-level agreements are followed by enterprises. There is general agreement and sporadic evidence suggesting, however, that the centrally set recommendations are serving as points of reference in the lower-level negotiations.

The raw data presented in Figure 7.1 compare actual average wage increases to the benchmarks in 1992–2007. Since the recommendations relate to the private sector the upper panel of the figure looks only at this sector. In the 1990s, the gap between the advisory maximum and minimum benchmarks was wide (partly because of uncertainty over future inflation) and the actual wage increases equalled or surpassed the upper benchmark. As the rate of inflation fell to single-digit levels at the end of the 1990s, the gap between the proposed maxima and minima grew narrower and the actual wage increases typically exceeded the upper limit. Looking at wage changes in the whole economy (lower panel), we observe a similar pattern except for the years of large wage hikes in the public sector. While the regulatory power of the central-level recommendations has so far remained an open question it seems that in several years the government itself deviated significantly from the ET guidelines.

1 Substantial changes were introduced to the Interest Reconciliation Council in 2011, please refer to the overview chapter for an update.

2 Government and trade-union initiated attempts at longer term agreements, committing unions to voluntary constraints on wage demands in exchange for government and employers' commitments failed in the mid-1990s. On these attempts see Héthy (1995) and Kóhegyi (1995).

FIGURE 7.1 | WAGE GROWTH AND THE RECOMMENDATIONS OF THE INTEREST RECONCILIATION COUNCIL, HUNGARY, 1992–2009

Source: Wage Survey

The fraction of employees covered by lower-level wage agreements fell substantially during the transition. According to firm-based data collected by the Office of Labour and Social Affairs, the share of workers covered by multiple-employer agreements amounted to 9.8 per cent in 1998 and only 1.1 per cent in 2008. Single-employer wage agreements covered 18.8 per cent of private sector employees in 1998, while ten years later the respective figure fell below 3 per cent (MT 2009: 293–94).

It is likely that the abovementioned figures underestimate the actual rate of coverage by collective wage bargaining. Presumably, in many cases, the negotiations do not result in written agreements but

the outcomes are nevertheless respected by the parties. One piece of evidence supporting this conjecture comes from the Labour Force Survey (LFS) of April–June 2001. In that year, 17 per cent of private sector employees reported that their wages were affected by collective agreements concluded inside or outside the firm, a ratio markedly exceeding the combined upper-bound estimate of coverage based on firm-level data (11 per cent).

The declining trend of unionization and formal agreements is nonetheless indisputable. Union membership started to fall sharply in the first decade of the new century: according to the LFS, the share of union members amounted to 20 per cent in 2001, 17 per cent in 2004 and 12 per cent in 2009.³ Likewise, the proportion of workers employed in unionized firms fell from 38 per cent in 2001 to 33 per cent in 2004 and 28 per cent in 2008. The share of workers covered by collective agreements declined from 25 per cent in 2004 to 21 per cent in 2009 (MT 2009; no similar data are available for 2001).

As in the case of wage agreements the figures on union density and collective agreements clearly indicate the direction of change but leave us in uncertainty regarding the levels. The estimates vary widely with the sources from which they come. In 2003, for instance, union federations reported a total membership of 824,000 (EIRO 2003), while the Tax Office reported only 600,000 people deducting union membership fees from their personal income tax base (Kun 2003). The LFS-based estimate fell closer to the latter figure, indicating a membership of 618,000 in 2001.

More important than the battle over membership size are the actual wage effects of unionization. These impacts are not necessarily restricted to union members and unionized firms since the uncovered enterprises may adjust to the covered ones. Furthermore, the wages achieved in sectors with high union density, such as mining (52.8 per cent in 2004), electric energy (59.9), transport and telecommunication (53.9), education (62.9), health (55.6) and public administration (51.1) may serve as reference points in the wage negotiations of other sectors.⁴ Finally, union wage gains may affect the wages of uncovered sectors in indirect ways, as suggested by the models of spillover effects, union threat and so-called “wait unemployment”.⁵

The research on union wage effects in Hungary has so far neglected the spillovers mentioned above, but several papers have addressed the wage gap between unionized and non-unionized firms.

Neumann (2002) analysed the effects of collective wage agreements on the level of wages and the incidence of low pay by estimating individual earnings functions and low-wage probits for 1998, using WS data. His estimates started from a raw gap of 30 per cent between covered and uncovered individuals and looked at how the gap was modified by the stepwise inclusion of controls. Allowing for gender, age and education reduced the gap to 25 per cent, the inclusion of industry and ownership brought it down to 18 per cent and controlling for firm size, the capital–labour ratio and productivity reduced it to an insignificant 5 per cent. Neumann found that, while collective agreements did not significantly affect firm-level average wages, they significantly reduced the incidence of low pay.⁶

3 These figures can be used to assess the direction of change but not the level of union coverage. In 2001, for instance, as much as 14 per cent of the respondents could not say whether their firms were unionised or not.

4 The quoted figures are presented in Tóth (2005)

5 Note that the extension of agreements is possible, albeit not mandatory in Hungary. The fraction of workers covered by multi-party agreements is negligible, as discussed in Koltay (2005).

6 This remained true until recently. In the firm panel analysed later in the paper the incidence of low pay (less than two-thirds of the median) was lower in covered firms by 3.3 per cent in 2008 and 3.9 per cent in 2009, after controlling for personal characteristics, industry and

Kertesi and Köllő (2003) estimated the union wage gap using the same data and assuming that product market concentration results in high levels of sales per worker, via monopoly rents and high levels of unionization simultaneously. (By contrast, Neumann's model implicitly assumed that productivity and union coverage are exogenous and independent of each other.) This assumption is conducive to a reduced form wage equation with concentration, unionization and their interaction on the right-hand side. Estimating the impact of these variables on industry-level earnings rents (coefficients of industry dummies from individual earnings regressions controlled for demographic and human capital variables) their paper found the interactive effect to be fairly strong. The elasticity of the industry wage rent with regard to industry-level coverage was found to be zero at low levels of market concentration and as high as 0.2 in the case of highly concentrated product markets.⁷ The elasticity of the industry rent with respect to market concentration ranged between zero (no collective agreements in the industry) and 0.26 (full coverage). The results were driven by a relatively small group of industries with high levels of market concentration, unionization and wages. The group included petroleum extraction and refining, the energy sector, post and telecommunications, rail, air and public transport, and the tobacco and chemical industries. The comparison of the Hungarian industrial wage structure with those of several European market economies reinforced that these industries indeed paid (and continue to pay) high wages relative to their Western counterparts. However, the paper's fundamental results were similar to Neumann's in suggesting a relatively weak effect of collective bargaining in the competitive sector as a whole.

In a recent paper, Rigó (2008) estimated the wage impact of collective bargaining using WS data from 1992–2005 and including information on nearly 16,000 firms with more than 2,100 status switches in terms of coverage by collective wage agreements. The data offered the opportunity to control for selection into union status. The paper estimated both individual and firm-level panel models with enterprise fixed effects capturing unobserved firm characteristics. In the firm-level regressions, the raw wage gap of 26 per cent fell to 8.9 per cent after controlling for observable firm characteristics, and to 4.4 per cent when including firm-level heterogeneity. The estimates on the individual-level database suggested a 26 per cent raw wage gap, which decreased to 7 per cent after controlling for individual and firm-level characteristics and to only 2 per cent when including firm-level unobservables.

The available evidence thus suggests that the direct effect of unionization on wages is rather weak in Hungary, except in highly concentrated industries with high levels of unionization. We also have one estimate suggesting that unionization reduces the incidence of low pay.

As opposed to the private sector, which is virtually unconstrained in wage setting at the upper tiers of the wage distribution, the public sector is subject to strict regulations, which set minimum and maximum salaries for civil servants (*köztisztvisel*) and minimum salaries for public sector employees (*közalkalmazott*). Herczog, Kézdi and Nunberg (1998) showed that market forces do affect the wage grid in that more marketable skills are paid closer to the competitive level. Nevertheless, budget institutions have restricted command over wages and their relative position in the pay hierarchy has been subject to large fluctuations in the past 15 years – an issue we shall come back to later in the chapter.

firm size. The results are available on request.

⁷ Coverage was measured as the combined number of workers in firms concluding collective wage agreements relative to total employment within the NACE-2 industry. Concentration was measured with the Herfindahl index and the four-firm concentration ratio.

Minimum wage regulation

An effective national minimum wage was introduced in 1989 by the country's last communist government. (Under state socialism, a legal wage floor was implicitly set as part of an overall wage grid system.) In 1990–98 and 2003–09, adjustments were negotiated annually by the national-level tripartite council, while in 1998–2002 the minimum wage was set unilaterally by the government.

Until recently, the minimum wage was related to monthly pre-tax “base wages” (earnings net of overtime pay, shift pay and bonuses), was legally binding and covered all employment contracts. For part-timers – accounting for 3–4 per cent of paid employment – the wage floor was proportionally lower but no other exceptions were made. In 2008, both monthly and hourly minima were set and they were differentiated by the worker's educational attainment and work experience, and the skill requirements of the job. In 2009, work experience was dropped from the criteria: the negotiations set a base minimum wage and a floor for workers with at least a secondary education.

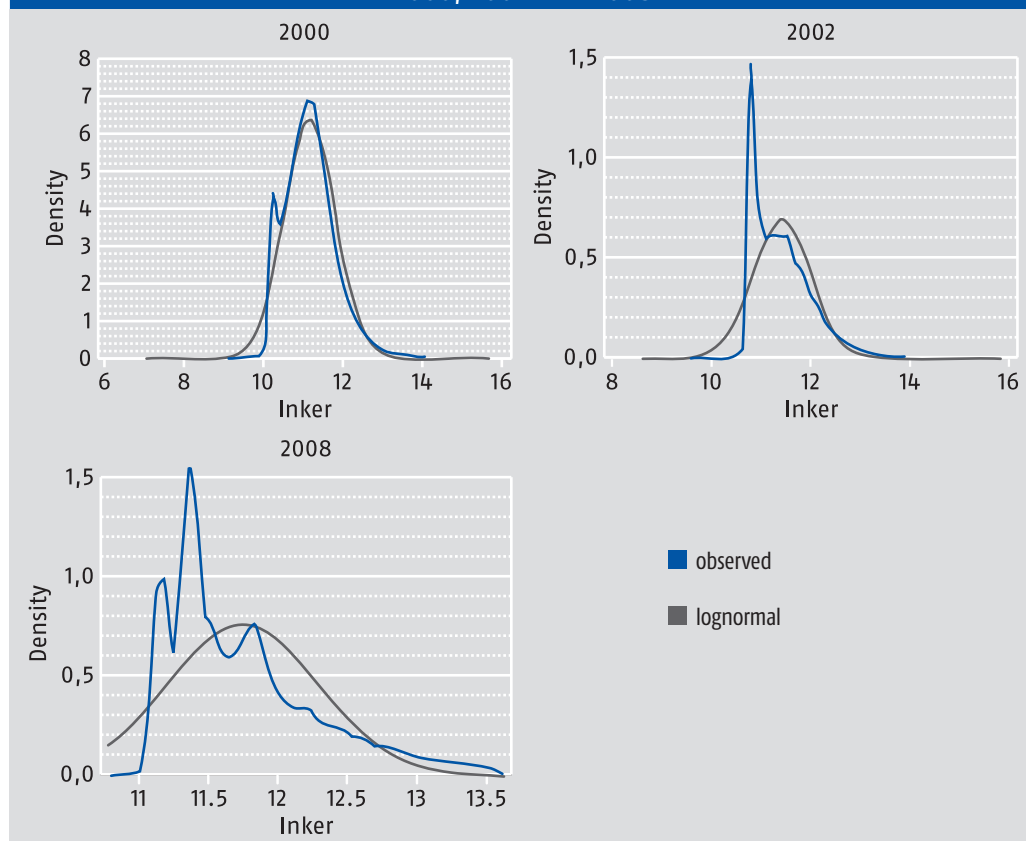
At its introduction the minimum wage amounted to 34 per cent of the average wage, while in 2000 (just before two major hikes) it stood at 29 per cent, a level far below the European average but only marginally lower than Spain's, the laggard within the EU. Despite its low Kaitz-index Hungary's minimum wage was effective already in 2000. The fraction of workers paid 95–105 per cent of the minimum amounted to 5 per cent – a ratio similar to those reported for Austria, Belgium, the Netherlands, Denmark, and the US by Dolado et al. (1996).⁸

The right-wing government in office between 1998 and 2002 nearly doubled the minimum wage, raising it from HUF 25,500 to HUF 40,000 in January 2001 and HUF 50,000 in January 2002. The two hikes increased the minimum wage–average wage ratio from 29 to 39 and 43 per cent, respectively. While the level of the minimum wage remained in the range characteristic of mature market economies, the adjustments taking place in 2001–02 were clearly exceptional. The hikes of 2001–02 had an enormous impact on the wage distribution. The first minimum wage hike implied a 28 per cent average wage increase for 21 per cent of the employees directly affected by the hike. The respective figures were 19 and 23 per cent at the second hike. As a result, the shape of the wage distribution changed markedly and deviated from the lognormal by 2002 (Figure 7.2).

Figure 7.2 also draws attention to the peculiarity that, in 2008, the wage distribution had three spikes, one at the base minimum wage, a second at the skilled workers' minimum wage and a third at double the base minimum wage. While the crowding of wage earners at the base minimum wage and the skilled minimum wage is hardly astonishing, the existence of a third spike requires explanation. The reason why many workers earn double the minimum wage is explained by the fact that, since 2007, firms are obliged to pay a minimum social security contribution that is set as a percentage of double the minimum wage. (The amount of the contribution is thus fixed for wages between the minimum wage and double the minimum wage.) This rule was introduced in order to tax a higher fraction of workers' total pecuniary remuneration that is assumed to consist of a reported minimum wage and an unreported “envelope wage”. The introduction of the minimum contribution base meant that many “cheating” firms could report higher-than-minimum wages without increasing their tax burden. The third spike in the

wage distribution was thus produced by firms doubling the reported wage of their “fake minimum wage earners”. The figures draw attention to the growing importance of minimum wage regulation in shaping the Hungarian wage distribution, on the one hand, and the existence of envelope wages, on the other.⁹

FIGURE 7.2 | THE DISTRIBUTION OF LOG GROSS MONTHLY EARNINGS, HUNGARY, 2000, 2002 AND 2008



Source: Wage Survey

Unions taking a cautious standpoint vis-à-vis the large minimum wage hikes of 2001–02 recently set more ambitious goals. For 2010, the employee side of the ET proposed a 13.5 per cent rise in the base minimum wage, arguing that its current level falls short of the subsistence minimum.¹⁰ In view of the

9 Elek et al. (2008) and Elek et al. (2009) provide indirect evidence of the massive resort to envelope wages by estimating a double hurdle model of the wage distribution and looking at the employment effect of the large minimum wage hikes in firms classified as “cheats” and “non-cheat” on the basis of the double hurdle estimates. The findings suggest that, in 2003, the median minimum wage earner actually earned 107 per cent of the minimum wage but those estimated to be cheating on taxes earned 174 per cent of the minimum wage. Consistent with expectations the scale and substitution effects of the large minimum wage hikes of 2001–02 appeared to be much weaker in the group of “cheats”.

10 The latest available data (as of February 2010) on the subsistence minimum, as estimated by the Central Statistical Office, relate to 2007 (CSO 2008). The estimate was HUF 66,271 for single persons and HUF 192,186 for families consisting of two adults and two children. The (net) minimum wage amounted to HUF 65,500. Two minimum wages and flat-rate allowances after two dependent children totalled HUF 156,400.

fact that the nominal average wage grew by about 2 per cent in the first half of 2009 (see below), and the crisis is not yet over, a minimum wage rise of this magnitude would further compress the wage distribution.

2 | Outcomes: wage evolution prior to the crisis

2.1 | Wage flexibility

Both macroeconomic models and micro-level research suggest that, despite the rigidities implied by the mandatory floors, wages remained flexible in Hungary.

Jakab and Kónya (2008) estimated a small open economy DSGE model with search and matching rigidities. One of their main findings is that, over and above what is implied by matching frictions, they do not find wages to be particularly rigid in Hungary. Using international comparative data collected in the Wage Dynamics Network, Kátay (2008) found that downward real wage rigidity is negligible in Hungary, while in terms of downward nominal rigidity the country is in a middle position within the EU. Wages are also more responsive to productivity shocks in Hungary compared to several Western European countries and react to transitory shocks. A comparison made in Druant et al. (2009), furthermore, suggests that Hungary belongs to the group of European countries without any formal indexation rule.

Several papers have focussed on how wages respond to variations in employers' ability to pay, on the one hand, and workers' reservation wages, on the other. (The former are usually approximated with variables such as sales per worker or profits per worker, while the latter are customarily measured indirectly, on the assumption that they respond to regional unemployment rates.) Repeated cross-section estimates based on the WS (MT 2003, 70) suggested that the elasticity of net wages with respect to the regional unemployment rate shifted from close-to-zero in 1989 to -0.1 in 1995–96 and have fluctuated around this value since then. (An elasticity of -0.1 is regarded as a benchmark in the wage curve literature, as shown in Blanchflower and Oswald 1995). While a wage curve similar to those observed in most developed market economies evolved during the transition, Kőrösi (2005) found no evidence of further downward adjustment in high-unemployment regions.

As far as the effect of ability to pay is concerned, the repeated cross-section estimates in MT (2000: 70) suggested that the elasticity of wages with respect to sales per worker rose from 0.05 to 0.25 in 1989–2000. In a more detailed analysis, Mickiewicz and Köllő (2005) regressed wages on sales per worker and regional unemployment, relying on a panel of 300 large firms over 1996–99 and using a fixed effects model with differenced variables and quantile regressions. All specifications suggested that the elasticity of the wage with respect to value added per worker falls between 0.21 and 0.26, consistent with the cross-section estimates quoted above. The paper found that wages are not generally responsive to changes in unemployment but fall substantially when rising unemployment is associated with falling firm revenues.¹¹

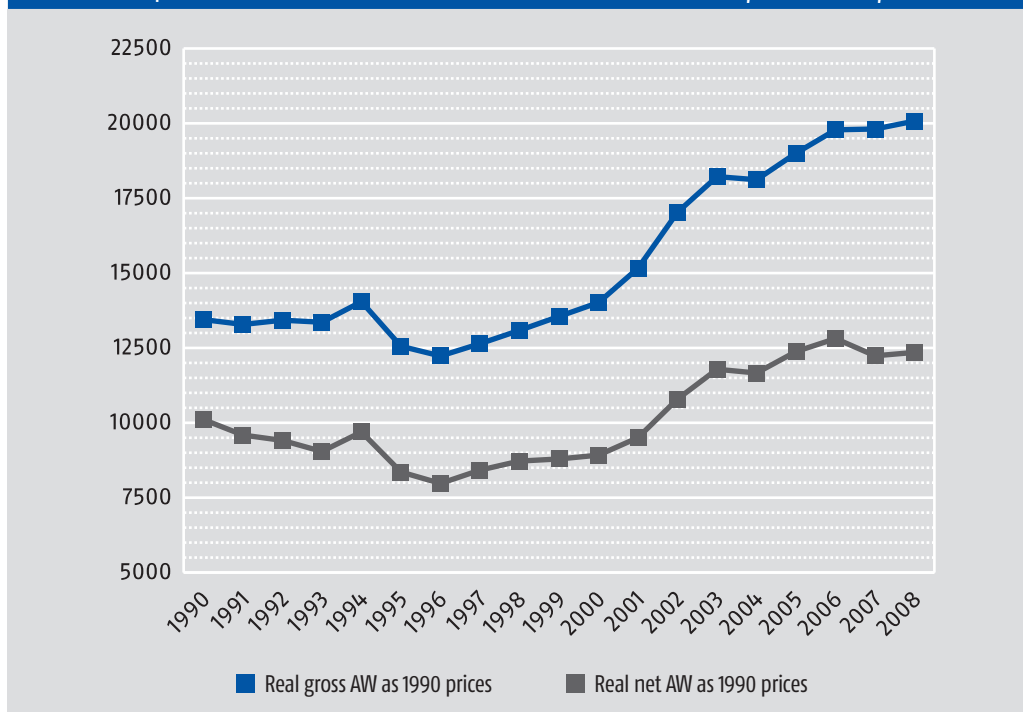
11 If, for instance, sales revenues fall by one-fifth and local unemployment increases by one-fifth, wages are expected to fall by one-twelfth. The same change in unemployment has no measurable impact when the firm's revenues are on the rise.

2.2 | Real wages and the wage share

The responsiveness of wages to changes in productivity predicts a stable wage share – an expectation clearly not supported by the aggregate data. As shown in Figure 7.2, the adjusted wage share has displayed large fluctuations in the past 15 years in Hungary – a pattern primarily explained by wage evolution in the public sector.

In the early years of the transition, real wages in Hungary did not fall as dramatically as in other Central and East European (CEE) countries, and they even increased in the election year of 1994 (Figure 7.3). A major shock to the real wage came in 1995–96 due to the cutting of public sector wages and an unanticipated rise in inflation, generated by what was called the “Bokros package”.¹² During implementation of the programme, real wages fell by 13 per cent in the public sector and 7 per cent in the private sector. After 1996, both gross and net real wages grew continuously, but slower than productivity. As a combined result of real wage cuts and subsequent wage moderation the adjusted wage share fell sharply, from 56 per cent in 1995 to only 50.7 per cent in 2000 (Figure 7.4).

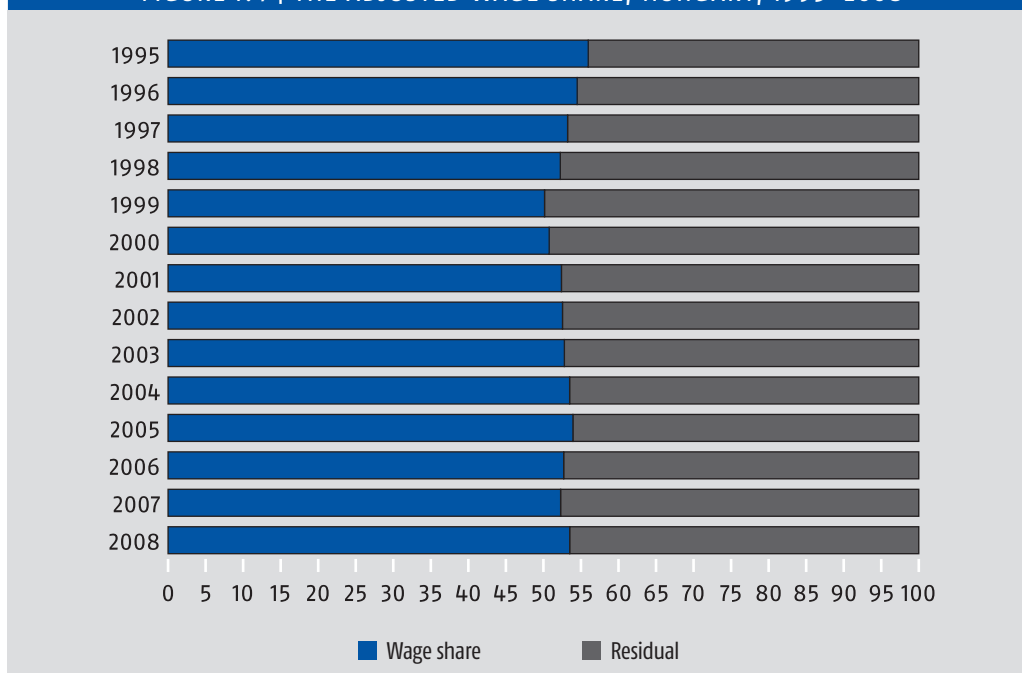
FIGURE 7.3 | THE EVOLUTION OF GROSS AND NET REAL WAGES, HUNGARY, 1990–2008



Source: CSO Stadat Database. Note 2009: 1st and 2nd quarters compared to the same quarters in 2008.

¹² The package, named after Finance Minister Lajos Bokros, included the devaluation of the forint, the shift to a crawling peg, a substantial increase in excise duties, cuts in public sector employment and a successful attempt to restrain real wage growth. The package stabilized the Hungarian economy without a significant loss of output and put it on a path of balanced growth until 2001. For an overview and evaluation of the package, see Kornai (1997).

FIGURE 7.4 | THE ADJUSTED WAGE SHARE, HUNGARY, 1995–2008



Source: AMECO

The first years after the millennium saw unprecedented rates of real wage growth, amounting to 8.2 per cent in 2001, 12.3 per cent in 2002 and 7 per cent in 2003. This process was fuelled by significant increases in public sector wages. In the course of 12 months preceding the 2002 elections, public sector wages grew by 17 per cent in real terms as opposed to only 7 per cent in the private sector. The new government went even further by raising the real wage of public sector employees by 29 per cent, compared to 11 per cent growth in the private sector.¹³ In 2003, private sector wages started to catch up, increasing at a rate of 11.5 per cent compared to a mere 3.6 per cent rise in the public sector – a process at least partly explained by spillover effects, as estimated by Kőrösi et al. (2007). Since real wages grew significantly faster than productivity in this period, the wage share rose from 50.7 per cent in 2000 to 54 per cent in 2005.

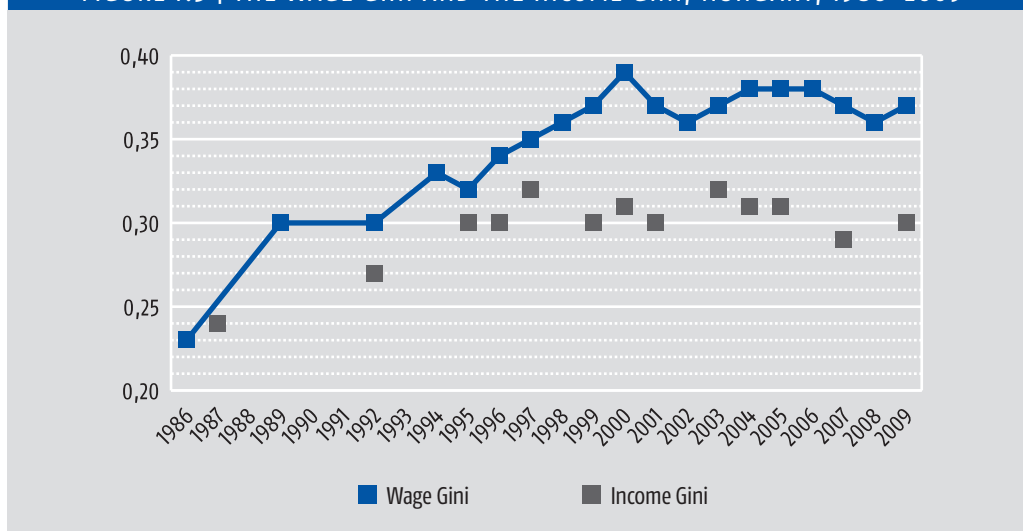
The price to be paid for overspending proved to be high. The budget deficit came within reach of 10 per cent of GDP in 2006, forcing the government to launch a new austerity programme. Hungarian economic growth was slowing down before the crisis. In 2007 and 2008, the real average wage grew by only 0.1 and 1.3 per cent, respectively.

¹³ The figures on wages and consumer prices relate to May and are based on the Wage Survey and the CSO's Stadat Data Base (<http://ksh.hu>), respectively.

2.3 | Relative wages

Decentralized wage setting allowed – and competition forced – enterprises to adjust their wage offers to workers' marginal product, which led to widening differentials between some groups and narrowing gaps between others. Overall, wage inequality increased strongly and almost monotonously during the transition, as shown in Figure 7.5. This process was only temporarily interrupted by the doubling of the minimum wage in 2001–02.¹⁴ The components of widening wage differentials have been subject to extensive research in the past 20 years.

FIGURE 7.5 | THE WAGE GINI AND THE INCOME GINI, HUNGARY, 1986–2009



Source: Wage Survey

Note: The wage Gini relates to gross monthly earnings (authors' calculation). The income Gini relates to the distribution of individuals by net monthly per capita household income, as estimated in Andorka and Harcsa (1990), Bedekovics et al. (1994), Tóth (2002), Szivós and Tóth (eds) (2001, 2004) and Tóth (2004), except for 1997 and 2004 (Bukodi et al. 2005) and 2007 and 2009 (Tóth and Medgyesi 2010).

Education. Growing returns to education played an important role in the process with the return to schooling rising from 0.059 in 1986 to 0.134 in 2005. (Authors' estimate with the basic Mincer equation using WS data.) Several papers looked at the details of growing education-related wage dispersion, and they agreed that the growing returns to university and college diplomas and the devaluation of uncertified vocational training were the key drivers.

Age. As far as age effects are concerned, the falling wages of older skilled workers relative to their younger counterparts decreased rather than increased the degree of overall wage inequality (see Kertesi and Köllő 2002; Kézdi 2002; Campos and Joliffe 2003; among others).

¹⁴ Note that the inequalities in gross earnings were not directly transmitted to inequalities of net per capita household income: during the transition, the income Gini grew in parallel with the wage Gini, but from 1998 onwards, further increases in wage inequality were not associated with growing income inequality (Figure 5).

Gender. The raw wage difference between men and women decreased substantially from 35.7 per cent in 1986 to 15.6 per cent in 2008, according to WS data. The evolution of the gender wage gap was analysed in several papers. Estimates controlling for personal and occupational characteristics (Table 7.1), as well as studies looking at within-firm differences (Lovász 2008), the residual wage distribution (Gulybán 2007) and selectivity bias corrected wages (Galasi 2000) unanimously concluded that the gender wage gap fell substantially between 1986 and 2003. A particularly careful analysis by Lovász (2008) tested Becker's (1957) model of employer taste discrimination, which implies that employers that discriminate against women may be forced out of the market by competition in the long run. She estimated the effect of variation in various measures of product market competition on the within-firm endowment-adjusted gender wage gap, making use of the fact that she was able to follow firms over time. Her estimates showed that strengthening product market competition was indeed conducive to diminishing within-firm gender-related wage differentials between 1986 and 2003. The effects of equal pay legislation, anti-discrimination initiatives and judicial practices (Box 7.1) have not been analysed in similar depth but they definitely contributed to the changing tone of public discourse over gender-related wage differentials.

**TABLE 7.1 | REGRESSION-ADJUSTED GENDER WAGE GAP, HUNGARY,
1986 AND 1996–2008**

1986	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
0.261	0.169	0.166	0.168	0.169	0.152	0.150	0.127	0.140	0.137	0.131	0.138	0.163	0.154

Source: Wage Survey

Note: The estimates show the log wage advantage of men over women. The estimates are controlled for educational attainment, experience, experience squared, a public sector dummy and 50 industry dummies. The wage figure is pre-tax.

BOX 7.1 | RATIFICATION AND IMPLEMENTATION OF ILO CONVENTIONS

Most of the ILO Conventions relevant for the present analysis were ratified by Hungary in the mid-1950s, although their systematic enforcement through acts and other sources of laws or collective agreements has been carried out only to a limited extent. In 1992, when the new labour legislation was enacted, certain parts of the ratified ILO Conventions were inserted into the new legislative texts.

In 2000, as part of a “legislative campaign”, 35 ILO conventions were incorporated into the Hungarian legal system by enacting the texts of the Conventions as Acts of Parliament. This resulted in some confusion in the legal system, because particular legal issues are regulated by two acts, for example, the right to collective bargaining by Act No. XXII of 1992 on the Labour Code and by Act No. LV. of 2000 on ILO Convention 98. The formal enactment of the ILO Conventions keep them isolated from other Acts developed through the usual legislative machinery and hinders their execution. Furthermore, the duplication of regulations on particular legal issues necessarily leads to certain contradictions among different items of law and, because these contradictions exist below constitutional level, it is not addressed by the Constitutional Court, and could be dealt with only on a case-by-case basis in day-to-day practice or by ordinary courts.

Act No. 125 of 2003 on equal treatment constitutes the main legislative framework on equal treatment in Hungary, although the obligation to provide equal pay for equal work is also stipulated by the Labour Code. The weakness of the legislative framework is that it leaves wide open the possibility for employers to exempt themselves from accusations of discrimination. Since 2006, according to a modification of the general provisions of Act No. 125 of 2003, it is not treated as unlawful discrimination if the employer differentiates among employees on the basis of reasonable criteria directly related to the legal relationship

Conventions	Ratification	Formal Enactment
Freedom of Association and Protection of the Right to Organize Convention, 1948 (C87)	6 June 1957	Act No. LII of 2000
Right to Organize and Collective Bargaining Convention, 1949 (C98)	6 June 1957	Act No. LV of 2000
Protection of Wages Convention, 1949 (C95),	8 June 1956	Act No. LIV of 2000
Equal Remuneration Convention, 1951 (C100)	8 June 1956	Act No. LVII of 2000
Discrimination (Employment and Occupation) Convention, 1958 (C111)	20 June 1961	Act No. LX of 2000
Minimum Wage Fixing Convention, 1970 (C131)	Not ratified	
Workers with Family Responsibilities Convention, 1981 (C156)	Not ratified	
Protection of Workers' Claims (C173)	Not ratified	

according to objective considerations.¹⁵ The chapter on employment goes even further by stipulating that it is not considered discrimination if the differentiation is proportionate and is justified by the character or nature of the work and is based on relevant and legitimate terms and conditions of the employment relationship.¹⁶ It is a widely shared view among labour lawyers that it is easy to exempt the employer from the liability for discriminatory actions on the basis of the legislative framework. In this regard, the Hungarian legislation is also in conflict with the relevant EU directives (Kádár 2008).

Certain procedural rules also hinder the implementation of the equal treatment act, for example, the lack of an ex officio procedure for the labour inspectorate in wage discrimination cases, including cases when the outcome of a general investigation into wages would suggest the possibility of a discriminatory wage structure. Furthermore, no procedure can be initiated without raising the case of a particular employee at the labour inspectorate or the Equal Treatment Authority.

Since January 2004, according to Art. 70/A of the Labour Code, an employer may issue an equal opportunities plan, together with the trade union or the works council.¹⁷ Implementation is not monitored; therefore, no data are available on the number of established equal opportunities plans. Equal opportunities do not seem to be a key industrial relations issue. A nationwide research study (Fodor et al. 2009) which analysed the content of the collective agreements of 17 branches of industry revealed that equal employment or equal pay issues were not included in the company-level collective agreements, with the exception of a single case that referred to the equal opportunities plan. The regulation of the equal opportunities plan seems proper. It suggests, first, a mapping of the employment situation of particular disadvantaged groups¹⁸ in terms of wages, working conditions, advancement, training and benefits related to child raising and parenthood. The second step is the setting of targets to remedy the situation, if necessary. Between 2004 and 2007 public employers and majority state-owned enterprises employing more than 50 employees were obliged to issue equal opportunities plans. Since this obligation was removed, even those companies which started the process have given it up (Borbély et al. 2009).

The issue of equal treatment and equal pay is still not a key area of public debate and planning. Equal pay does not seem to be a central policy-making issue, either. The law on equal pay is not strict and there are several procedural rules that hinder its implementation. The number of equal opportunities plans put in practice is unknown and predictably low.

¹⁵ Act No. 125 of 2003, Art. 7 (2).

¹⁶ Act No. 125 of 2003, Art. 22 (1) a.

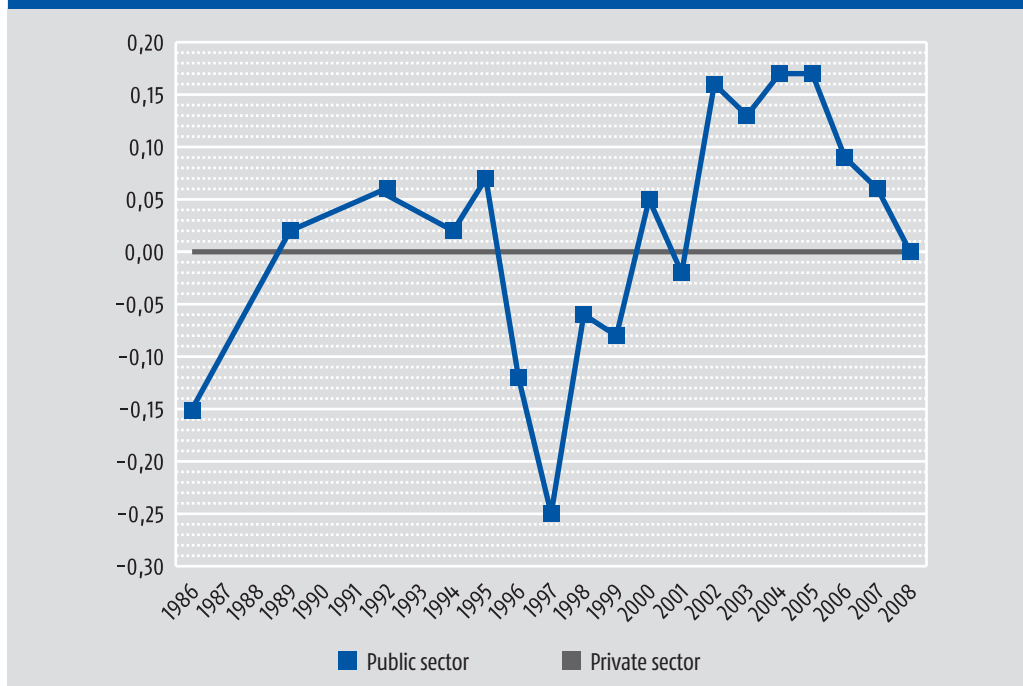
¹⁷ Between 2004 and 2007 there was an obligation to draw up a nationwide equal opportunities plan. Also, public employers and mainly state-owned enterprises employing more than 50 employees were obliged to issue an equal opportunities plan. This regulation was abolished on 1 January 2007.

¹⁸ The groups include women, employees over 40 years of age, Roma, employees with disabilities, parents raising two or more children below the age of 10 and single parents raising a child younger than 10.

While the studies quoted above worked with data from 1986 to 2003, more recent estimates suggest that the gender wage gap started to widen after a low point in 2002. As shown in Table 1, the regression-adjusted wage advantage of men increased from 0.127 log points in 2002 to about 0.16 in 2006–07. Due to the lack of research on this period it is hard to identify the causes of trend reversal. The raw data suggest that the patterns of gender differentials did not change significantly: the gap continues to be similar across sectors, wider in large firms than in small ones but marginally narrower in firms covered by collective agreements.¹⁹

Sectors. The difference between public and private sector wages fluctuated in a wide range in response to government decisions on downward and upward adjustments of two-digit percentages (Figure 7.6). The regression adjusted public-private gap (controlled for gender, age, education, two-digit industry and NUTS-3 regions) widened slightly in the early years of the transition but the Bokros package brought the relative wage of public sector employees down from 107.5 per cent in 1995 to only 87.5 per cent in 1996. After the stabilization programme, public sector wages were slowly catching up and became virtually equal to private sector wages by 2001. The socialist government coming to power in 2002 raised the base wages of public sector employees by 50 per cent, which implied that the relative earnings of public sector workers jumped from 97.8 per cent in 2001 to 116.4 per cent overnight. The wage advantage of the public sector remained at this level until 2005 and has been slowly declining ever since. As will be discussed in Section 3, the crisis brought about severe wage cuts in the public sector, suggesting that the public-private gap may close by the end of 2009. While market forces do play a role in shaping the public-private gap, the political cycle and the resulting fiscal pressures seem to exert a more profound influence.

¹⁹ In 2008, the raw gap amounted to 7.6 and 5.2 per cent in the uncovered and covered small firms, respectively, while the respective figures were 32.6 and 28.6 for large firms employing more than 50 workers. For a recent discussion of why collective bargaining is likely to lead to a smaller gender wage gap, see Heinze and Wolf (2010), who identify such an effect in Germany.

FIGURE 7.6 | REGRESSION-ADJUSTED LOG PUBLIC-PRIVATE WAGE GAP, HUNGARY, 1986–2008

Source: Wage Survey

Note: The estimates are based on the Wage Survey and relate to log gross monthly earnings. The controls include gender, age, education, 2-digit industry, NUTS-3 regions, settlement type and the micro-region unemployment rate.

Ownership. Last but not least, in the course of the transition seemingly large wage differences evolved between domestic and private firms. Using WS data, Earle and Telegdy (2007) estimated the extent to which a large unconditional wage gap (40 per cent) could be accounted for by worker characteristics, industry affiliation, firm size and unobserved firm characteristics. They found that the data are little affected by conditioning on worker characteristics, but controlling for industry reduces the foreign premia to 34 per cent, and controlling for employment size further reduces it to 28 per cent. In their panel model they exploit the presence of 3,700 switches of ownership type to estimate firm fixed-effects and random trend models accounting for unobserved firm characteristics affecting the average level and trend growth of wages. These controls reduced the estimated foreign premium to 7 per cent.

To summarize, 20 years after the transition, Hungarian wage inequality has reached a level characteristic of Western OECD countries. While the level of inequity cannot be considered particularly high its rate of growth has been spectacular by any standards. During the widely discussed growth of wage inequality in the US, the Gini of weekly earnings grew from 0.39 to 0.44 between 1979 and 1996 (Bernstein and Mishel 1997). In the Hungarian transition the Gini of monthly earnings rose from 0.23 in 1986 to 0.38 (gross earnings) and 0.35 (net earnings) in 2000, implying that the annualized change in the Gini in a

period of comparable length amounted to more than four times the US value.²⁰ In terms of differences between social groups and sectors the results were diverse: in some dimensions, such as education, the gap between groups widened, while in others (such as gender and age groups) it grew narrower. Sectoral differences were restructured rather than increased and they often appear to be smaller than suggested by the raw data. The evolution of the public–private gap was mainly driven by the political cycle.

2.4 | Lessons for the study of the crisis

The most important facts summarized in the preceding sections seem to have lessons for what to study with the data which are available for the period of the financial crisis.

First, the flexibility of wages is expected to play an important role in adjustment to the crisis. In those sectors in which skilled labour is employed, screening and training costs are considerable and firms are likely to prefer wage cuts to dismissals and closures. The case is similar with firms that, in the past, helped their workers to accumulate firm-specific knowledge: by dismissing former trainees they would lose the accumulated skills and put the returns to their investment at risk. Likewise, groups with inelastic supply, such as prime-age males, are more likely to accept wage cuts as the price to be paid for retaining their jobs.

Second, while union density is relatively low in Hungary, even so about one-fifth of the workforce is employed in unionized firms and union coverage exceeds one-third in several branches. The question of how the presence of unions has affected the mix of employment and wage adjustment seems to be an interesting one that can be addressed with the data at our disposal.

Third, minimum wage regulations can make wage adjustment difficult for many firms and may motivate them to cut staff numbers and/or working hours instead. Therefore, we shall pay special attention to low-wage firms and low-wage workers.

3 | Responses to the crisis, 2008–2009

3.1 | Differences between the public and private sectors

As a small, open economy deeply integrated in the European product and financial markets, Hungary has been hit hard by the crisis since October 2008. Fiscal risks and its commitment to agreements made with the EU and the IMF prevented the Hungarian government from major interventions during the crisis, thus yielding ground to market forces. Real GDP is expected to fall by 6.7 per cent in 2009 on a year-on-year basis, according to the National Bank's forecast (MNB 2009). Exports fell by 21.5 per cent between January and March 2008 and 2009, despite a dramatic devaluation of the forint (235 HUF/€ in August 2008 and 320 HUF/€ in March 2009).²¹ On the verge of financial collapse, Hungary had to apply to the IMF, the World Bank and the EU for loans amounting to a total of 20 billion euros. The government, committed

²⁰ Personal income taxation was introduced in 1987 thus the data from 1986 should rather be treated as net figures.

²¹ The forint partly recovered by July 2009 with the exchange rate settling in the range of 265–275 HUF/€

to keeping the budget deficit below 4 per cent in 2009 and push it further down in 2010, introduced a series of austerity measures, including the abolition of the thirteenth-month wage in the public sector.

TABLE 7.2 | CHANGES IN THE GROSS MONTHLY AVERAGE WAGE, HUNGARY, JANUARY–NOVEMBER 2008 AND 2009

	Public sector	Private sector	Total
Wages			
Real monthly gross earnings	–11.5	0.4	–3.5
Real monthly gross base wages	–5.7	1.0	–0.6
Real monthly net earnings	–8.7	0.3	–2.4
– without jobs in public works schemes	–7.4	–	–
Employment	3.4	–6.8	–3.8
– without jobs in public works schemes	–0.4	–	–

Source: CSO, 21 January 2010.

The latest available wage statistics (Table 7.2) suggest that, in the economy as a whole, gross real wages fell by 3.5 per cent in January–November 2009 compared to the same period in 2008, but the decline seems less dramatic (–2.4 per cent) if the net real wage is considered. The abolition of the thirteenth month wage and an effective wage freeze implied an 11.5 per cent decline of the real wage in the public sector, while in the same period, private sector wages grew by 0.4 per cent in real terms. By contrast, employment fell significantly, by 6.8 per cent, in the private sector as opposed to an increase of 3.4 per cent in the public sector. As suggested by the last row of the table, the growth of employment in the public sector was fully accounted for by inflows to public works programmes.

The observed changes in monthly average wages were also affected by working hours adjustments. As shown in Table 7.2, total hours did not change significantly in the public sector, but average monthly hours per worker fell in the second quarter of 2009.²² By contrast, in the private sector, total labour input fell by 6.3 and 10.4 per cent, depending on which quarters are compared, and those who remained in their jobs had 1.7 and 2.9 per cent shorter working time compared to the same period in 2008.²³

²² This is partly explained by inflows to an extended public works programme (Pathways to Work), implying a rise in headcount and a fall in average hours.

²³ At the time of writing, no annualized figures were available on wage growth and the latest data on working time relate to January–June 2009.

TABLE 7.3 | PERCENTAGE CHANGES IN WORKING HOURS BETWEEN, HUNGARY, JANUARY–JUNE 2008 AND 2009

	2009 1 st quarter	2009 2 nd quarter
Changes in total hours		
Both sectors	–4.4	–7.5
Public sector	0.0	–0.2
Private sector	–6.3	–10.4
Changes in average monthly hours per employee		
Both sectors	–1.1	–2.8
Public sector	0.8	–3.2
Private sector	–1.7	–2.9

Note: The data are institution-based and relate to firms employing 5 or more workers and budget institutions. The data relate to changes between the respective quarters of 2008 and 2009.

Source: Central Statistical Office, Statinfo Data Base, <http://ksh.hu>

The available data thus suggest that, in the public sector, the response to the crisis typically took the form of wage cuts and hours reduction. In the private sector, employment fell dramatically and the working week was shortened, but the average wage increased slightly, even in real terms.

In the rest of this chapter, we shall analyse the changes in employment and monthly gross average wages in the private sector at the enterprise level, using the data of 5,396 firms observed in the May 2008 and 2009 waves of the WS.

3.2 | Wages and employment in the private sector – estimation and data

We estimate two equations explaining the log changes of employment (L) and average wages (w) with the same set of explanatory variables on the right hand (equation 1). Beyond comparing the parameter vectors β and γ we shall also look at the correlation of the residuals u and v .

$$(1) \Delta \ln L_i = X_i \beta + u_i, \Delta \ln w_i = X_i \gamma + v_i$$

Employment will be measured in two ways: (i) with the number of employees and (ii) with total labour input calculated as the product of staff numbers and average paid working hours in May. The explanatory variables relate to firm characteristics in the base period, such as size, ownership, coverage by collective agreement, industrial and regional affiliation and composition of the workforce by gender, experience and education. The share of minimum wage workers in the base period is also included as an explanatory variable.

The analysis relates to 5,396 firms observed in 2008 and 2009, that is, a sub-sample of the 9,084 enterprises reporting data in the 2008 wave of the WS. Selection to the panel is affected by the sampling design of the survey, firm exit and non-response. In order to understand the impact of the sampling procedure one should bear in mind that all Hungarian firms employing more than 20 workers are obliged to fill in the WS questionnaire, while in the case of smaller firms a 20 per cent random sample is selected and obliged to report. A medium-sized or large firm can vanish from the WS if it goes bankrupt or

drops below the 20-worker limit and is not selected for the randomly chosen small-firm sample. The probability that a small firm observed this year is also observed next year is 0.2 if it continues to employ fewer than 20 workers, and 1.0 if it grows large enough to be included in the “medium-sized and large” category. In fact, out of the base period sample of 9,084 enterprises, 39.5 per cent of the small firms and 71.7 per cent of the larger ones were observed in May 2009.

Selection to the panel was analysed with a probit model. As shown in Appendix Table A1, several base period characteristics had a significant impact on the probability of being observed twice. Firm size obviously mattered but so did ownership, gender composition and industry. Unexpectedly, state-owned enterprises were less likely to be observed in 2009 and the same applied to private firms operating in branches dominated by public institutions (education, health and cultural services). Firms covered by collective agreements and those with a high share of male employees were more likely to report data in 2009.

Relying on the probit coefficients, we estimated the probability of selection to the panel for each firm (p_i) and used $1/p_i$ as a weight in the forthcoming calculations.

Measurement error in some of the variables raises further questions to be addressed. On the one hand, we measure the composition of the workforce with error in some firm size categories. On the other hand, we have doubts over the reliability of observations on working hours. The first problem arises because enterprises employing more than 50 workers report individual data on a roughly 10 per cent random sample of their employees, unlike smaller ones, which report data on all of their workers.²⁴ Consequently, in small and large firms the observations on staff composition are fully or adequately precise but the data of medium-sized enterprises are undoubtedly noisy. As far as the second problem is concerned, it is likely that the changes of actual working hours are not always reflected in the reported data: when it comes to the reduction of working hours and the cutting of extra tasks some firms simply pay less for a shorter actual workweek without rewriting the employment contracts and/or modifying their book-keeping programs. If many firms do so an apparent negative correlation arises between hourly wages and working hours – a fact supported by our experiments.²⁵ We shall use the data on working hours but treat them with some suspicion.

3.3 | Descriptive statistics

The figures on changes of employment, wages and hours in the firm panel (Table 7.4) present a picture similar to that based on CSO data. Employment fell dramatically by 8.9 per cent, average working hours were cut by 2.2 per cent, while real wages did not change significantly. The real wage indices fall between –0.9 and +1.5 per cent, depending on whether non-regular bonuses and premia are included.

²⁴ In large firms workers are selected on the basis of their birthday.

²⁵ When we estimated a three-equations system similar to (1), with employment, hourly wages and working hours on the left hand, we found a correlation of –0.44 between residual hours and residual hourly wages. This result reflects, at least partly, the variations in reporting practices rather than a trade-off between hours and wages. If all firms cut working hours but only some of them report it, while they all hold genuine hourly wages constant, the calculated hourly wages (monthly pay/observed hours) fall and observed hours remain constant in the non-reporting group. In the reporting group the calculated hourly wage rises and hours fall.

TABLE 7.4 | CHANGES IN THE FIRM PANEL VERSUS THE WHOLE PRIVATE SECTOR, HUNGARY, 2008–2009

	Firms employing at least 5 workers	
	Private sector	Firm panel
	2009 Q2 / 2008 Q2	2009 May / 2008 May
Employment	–7.6	–8.9
Average monthly working hours	–2.6	–2.2
Gross monthly earnings	1.4	–
Gross monthly wage	–	1.5
– Regular supplements included	–	0.0
– Previous year's bonuses included	–	–0.9

Note: All data relate to firms employing at least 5 workers.

Source: Data on the entire private sector are drawn from the Central Statistical Office's homepage www.ksh.hu

It seems that, in the private sector, wage inequality did not change dramatically. Table 7.5 presents four standard measures of inequality. The Gini is a well-known indicator of overall inequity, while the other three measures are more sensitive to changes in the upper and lower tails of the distribution (coefficient of variation and Theil's mean log deviation, respectively) or shifts at the extremes (P95/P5). Each of the four indicators suggests only a minor rise in inequity.²⁶

TABLE 7.5 | THE INEQUALITY OF GROSS MONTHLY EARNINGS, HUNGARY, MAY 2008 AND 2009 (FIRM PANEL)

	2008	2009
P95/P5	6.10	6.25
Coefficient of variation	1.168	1.195
Gini	0.3564	0.3615
Theil's mean log deviation	0.2052	0.2101

Note: Data from the firm panel introduced in detail in the text

The minimum wage clearly had a strong impact on the wage distribution, as suggested by the curve in Figure 7.7. On 1 January 2009, the base minimum wage was increased by 3.6 per cent and the skilled minimum wage was raised by 1.1 per cent. The abolition of experience as a criterion implied that the minimum wage of skilled workers with less than two years' experience rose by 5.3 per cent. The data points of Figure 7 show the difference between the size distributions of individual wages in the firm panel in 2008 and 2009. More precisely, we counted (with HUF 1,000 precision) how many workers were paid HUF 48,000, 49,000, ..., 200,000 a month and deducted the 2008 frequencies from the 2009 ones. The results for wages exceeding HUF 200,000/month are suppressed in order to maintain visibility. One can easily observe how large masses of workers paid at the base minimum wage, skilled minimum wage

²⁶ Note that the figures relate to different populations in 2008 and 2009. The changes are affected by shifts in individuals' wages, as well as changes in the composition of the workforce in the firm panel.

and double the base minimum wage were shifted to the new values of these floors. Outside the narrow regions around the old and new minima the size distributions were practically identical in 2008 and 2009.

FIGURE 7.7 | CHANGE IN THE WAGE DISTRIBUTION, HUNGARY, 2008–2009



Source: Wage Survey

Note: Gross monthly wages were rounded. The curve shows how the number of workers earning 50, 51, ..., 200 thousand Forints changed between May 2008 and May 2009. The figures relate to firms employing at least 5 workers. Data: Wage Surveys 2008 and 2009.

The stability of the wage distribution and the lack of substantial changes in inequity do not imply that everything was quiet on the wage front. The case was rather that some of the sizeable shifts identified in the next section increased, while others decreased the degree of overall earnings inequality.

3.4 | Estimation results

The estimation results of system (1) are presented in Table 7.6. We have four specifications, differing in two aspects. In specifications *A* and *C* the dependent variable of the employment equation is the number of workers. This was replaced by total labour input in specifications *B* and *D*. Despite the doubts discussed earlier concerning the reliability of the hours measure, we use it in order to capture at least a part of the working time adjustment during the crisis.

Versions *A–B* and *C–D* differ in the samples used for the estimations. Since we work with changes in employment and wages, some extreme values may occur even after taking logs. In order to reduce the impact of heavy outliers we re-estimated the equations by excluding 34 firms, where the absolute value of log changes in either employment or wages exceeded 2.

TABLE 7.6 | ESTIMATES OF LOG CHANGES OF EMPLOYMENT AND WAGES, HUNGARY

Sample	All firms							
Version	A				B			
Dependent variable	Employment		Wage		Labor input		Wage	
Share of men	-.0574	-2.98	-.0354	-3.28	-.0544	-2.74	-.0354	-3.28
Average experience	.0014	1.69	-.0019	-3.99	.0016	1.88	-.0019	-3.99
Average education	.0189	4.40	-.0051	-2.14	.0188	4.25	-.0051	-2.14
1–10 employees	.1332	9.19	.0030	0.38	.1265	8.48	.0030	0.38
11–20 employees	.0597	3.69	.0026	0.29	.05	3.39	.0026	0.29
21–50 employees	.0163	1.07	-.0084	-0.99	.0196	1.25	-.0084	-0.99
Fraction paid the MW	-.0186	-1.02	.0311	3.04	-.0256	-1.36	.0311	3.04
Collective agreement								
Only 2008	.0083	0.36	-.0010	-0.08	.0040	0.17	-.0010	-0.08
Only 2009	-.0127	-0.61	.0013	0.11	-.0051	-0.24	.0013	0.11
Both 2008 and 2009	.0340	2.21	.000	0.05	.031	1.97	.000	0.05
Foreign-owned	.0294	1.92	.0039	0.46	.0256	1.63	.0039	0.46
State-owned	.0835	3.49	.0223	1.66	.1000	4.05	.0223	1.66
Local unemployment	-.0091	-1.07	-.0146	-3.08	-.0073	-0.83	-.0146	-3.08
Agriculture	.0990	4.15	-.0006	-0.05	.1156	4.71	-.0006	-0.05
Mining	.0378	0.58	.0281	0.76	.0977	1.44	.0281	0.76
Water & sewage	.0808	2.40	-.0296	-1.57	.0845	2.43	-.0296	-1.57
Construction	-.0208	-1.02	-.0140	-1.23	-.0090	-0.43	-.0140	-1.23
Trade	.0128	0.82	-.0319	-3.61	.0259	1.60	-.0319	-3.61
Transport	.0198	0.79	-.0262	-1.86	.0339	1.31	-.0262	-1.86
Hotels	.0218	0.73	-.0421	-2.52	.0386	1.26	-.0421	-2.52
Communication	.0854	2.45	.0102	0.52	.1068	2.97	.0102	0.52
Finance & insurance	.0490	1.44	-.0043	-0.23	.080	2.31	-.0043	-0.23
Real estate	-.0385	-1.03	-.0199	-0.95	-.0332	-0.86	-.0199	-0.95
Professional services	.0063	0.21	-.0193	-1.15	.0309	1.00	-.0193	-1.15
Administrative services	-.0437	-1.64	-.0212	-1.42	-.0309	-1.12	-.0212	-1.42
Education (private)	-.1168	-2.15	.0322	1.06	-.0872	-1.56	.0322	1.06
Health (private)	.0699	2.20	.09	5.44	.0737	2.25	.09	5.44
Culture (private)	-.0504	-1.07	-.053	-2.02	-.0827	-1.70	-.053	-2.02
Personal services	.152	3.21	-.0455	-1.72	.1498	3.07	-.0455	-1.72
Constant	-.3754	-5.94	.1128	3.18	-.4024	-6.17	.1128	3.18
Number of observations	5396				5396			
Root mean squared error	0.3716		0.2079		0.3824		0.2079	
“R-squared”	0.0460		0.0246		0.0453		0.0246	
Correlation of residuals	-0.0336				-0.0419			
Breusch-Pagan chi2	6.086 (0.0136)				9.487 (0.0021)			

TABLE 7.6 | ESTIMATES OF LOG CHANGES OF EMPLOYMENT AND WAGES (continued)

Sample	All firms							
Version	C				D			
Dependent variable	Employment		Wage		Labor input		Wage	
Share of men	-.056	-3.49	-.0352	-3.37	-.0543	-3.23	-.0352	-3.37
Average experience	.0011	1.57	-.001	-3.41	.0013	1.80	-.001	-3.41
Average education	.0148	4.09	-.0033	-1.44	.0147	3.91	-.0033	-1.44
1-10 employees	-.0210	-1.37	.0301	3.05	.0895	7.07	.0044	0.56
11-20 employees	.096	7.88	.0044	0.56	.0223	1.58	.0056	0.64
21-50 employees	.0252	1.85	.0056	0.64	.0002	0.02	-.0061	-0.73
Fraction paid the MW	-.00	-0.24	-.0061	-0.73	-.0285	-1.79	.0301	3.05
Collective agreement								
Only 2008	.0152	0.78	-.0014	-0.11	.0107	0.53	-.0014	-0.11
Only 2009	-.0010	-0.06	.0038	0.34	.0065	0.36	.0038	0.34
Both 2008 and 2009	.0316	2.44	.0062	0.75	.0286	2.13	.0062	0.75
Foreign-owned	.0093	0.73	.007	0.87	.0055	0.42	.007	0.87
State-owned	.050	2.51	.0184	1.42	.0667	3.18	.0184	1.42
Local unemployment	-.0064	-0.90	-.0147	-3.20	-.0043	-0.59	-.0147	-3.20
Agriculture	.0738	3.67	.0014	0.11	.0901	4.33	.0014	0.11
Mining	.0422	0.77	.0277	0.78	.1020	1.78	.0277	0.78
Water & sewage	.1082	3.80	-.0168	-0.92	.1123	3.81	-.0168	-0.92
Construction	.0052	0.30	-.0118	-1.07	.0180	1.01	-.0118	-1.07
Trade	.0174	1.31	-.0300	-3.51	.0304	2.21	-.0300	-3.51
Transport	.0383	1.80	-.0177	-1.29	.0531	2.41	-.0177	-1.29
Hotels	.0200	0.80	-.0385	-2.38	.0367	1.41	-.0385	-2.38
Communication	.0392	1.33	.007	0.39	.0605	1.97	.007	0.39
Finance & insurance	.0456	1.60	-.004	-0.25	.0770	2.60	-.004	-0.25
Real estate	-.0135	-0.43	-.0288	-1.42	-.0080	-0.26	-.0288	-1.42
Professional services	.0165	0.65	-.0203	-1.25	.0411	1.57	-.0203	-1.25
Administrative services	-.0259	-1.15	-.0210	-1.45	-.0128	-0.55	-.0210	-1.45
Education (private)	-.104	-2.28	.0317	1.08	-.0748	-1.58	.0317	1.08
Health (private)	.1019	3.79	.0951	5.50	.1056	3.79	.0951	5.50
Culture (private)	-.0456	-1.15	-.0502	-1.97	-.0779	-1.90	-.0502	-1.97
Personal services	.1285	3.22	-.0405	-1.58	.1240	3.01	-.0405	-1.58
Constant	-.2906	-5.45	.0804	2.34	-.3151	-5.70	.0804	2.34
Number of observations	5362				5362			
Root mean squared error	0.3116		0.2041		0.3227		0.2007	
“R-squared”	0.0456		0.0241		0.0448		0.0241	
Correlation of residuals	-0.0154				-0.0267			
Breusch-Pagan chi2	1.278 (0.2583)				3.830 (0.0503)			

Source: Wage Survey

The test statistics of the estimations are satisfactory, although they explain only a small part of the total variance – as frequently happens when we have indicators of short-run changes on the left hand.²⁷ The qualitative results of the four specifications are similar as far as the most important points are concerned. Our preferred specification is *D*, where employment is measured in terms of total hours and the heavy outliers are excluded – this is the version we follow in interpreting the results.

Gender. One of the robust results that hold across specifications and estimation samples is that firms employing a predominantly male labour force cut both employment and wages more deeply than did female-dominated enterprises. A one standard deviation (30.7 per cent) difference in the share of male employees implied a difference of 1.7 per cent in the change in employment and 1.1 per cent difference in the change in the average wage, holding other firm characteristics equal. (For the mean and standard deviation of the variables in the models, see Appendix Table A2.) This result holds after controlling for industry and firm size and probably reflects the fact that production was more severely hit by the crisis than auxiliary activities and office jobs.

Experience. Our preferred specification suggests that firms employing an older labour force were less likely to cut employment and more likely to cut wages than did their counterparts employing young workers. The wage effects are highly significant in all specifications, while the employment effect is significant only at the 0.07 level in specification *D* and insignificant elsewhere. The magnitude of the wage effect is relatively small: a one standard deviation difference in average base-period experience (6.78 years) was conducive to a 1.1 per cent difference in the change in the average wage, while the employment effect amounted to 0.9 per cent.

Education. The level of education measured in terms of average school years completed by the firm's employees exerted a strong positive influence on employment and a weak negative impact on wages. In our preferred specification, a one-year advantage in the workforce's average level of education implied almost 1.5 per cent higher employment in 2009 compared to 2008. A firm whose labour force was more educated by one standard deviation reported 2.2 per cent higher employment in May 2009 compared to its otherwise identical counterpart. The effect of average educational level on staff numbers was stronger than the effect on total labour input, suggesting that firms employing a skilled labour force were more likely to cut working hours. The wage effect of education is insignificant and weak in our preferred specification (–0.3 per cent), but significantly negative and stronger when the heavy outliers are included in the sample (versions *A* and *B*).

Firm size. In terms of average monthly wages, we do not observe any difference between large and small firms, but small firms (employing fewer than 50 workers) had a better employment record than their larger counterparts. Compared to 2008, small businesses had 13 per cent higher employment and 9 per cent higher labour input than large corporations, holding other things equal. This disparity is probably explained by indivisibilities. Consistent with this speculation, the results suggest that small firms were more likely to adjust to shocks by cutting working hours.

27 The systems were estimated with Stata's *mvreg*. The coefficients would be the same if the equations were estimated separately with OLS, but *mvreg* yields information on the correlation of the residuals, which is important in the case examined here. Note that the wage equations are identical for versions *A–B* and *C–D*.

Ownership. The estimates suggest no difference in the employment and wage records of foreign-owned and domestic private enterprises. However, state-owned firms kept the level of labour input higher by 6.7 per cent and employment higher by 8.4 per cent than private ones. Their wage records were also more favourable (positive effects of between 1.8 and 2.2 per cent) although the estimates are weakly significant in versions A and B and not significant at conventional levels in versions C and D. In evaluating these outcomes one should keep in mind that most of the remaining state firms in Hungary (7 per cent of the sample) operate in markets protected from the direct effects of the worldwide recession.

Industries. In the employment equations most of the parameters of the industry dummies are positive, suggesting that manufacturing industry (the reference category) lost more jobs than did other sectors of the economy. Only cultural services has a statistically significant negative parameter ($t=0.057$) in one of the four specifications. Compared to manufacturing, wages seem to have fallen more drastically in retail trade, hotels and restaurants and cultural services – the respective parameters are highly significant and amount to about –4 per cent on average. Several other branches of the tertiary sector also have negative parameters (finance and insurance, professional, administrative and personal services) but the effects are statistically insignificant.

Regions. Regional differences are captured by the firm-level weighted average of the micro-region unemployment rates relevant for the firm's geographically distinct branches. The estimates suggest that a one standard deviation disadvantage in terms of unemployment predicted a slower rate of wage growth by 1 per cent. At the same time, regional unemployment had no impact on employment. This finding is consistent with the experience that, compared to previous shocks, the recent crisis had a more balanced regional effect.

Minimum wage workers. We now turn to the results directly relevant for policies, at least potentially. In our preferred specification we obtain the result that a higher share of minimum wage workers was conducive to higher average wage growth, holding other wage determinants constant. The estimated coefficient of 0.03 predicts that firms employing only minimum wage workers raised the average wage faster by about 3 per cent compared to firms with no minimum wage workers at all. This is exactly what we expect (under full compliance and no immediate spillover effects) when the minimum wage increases by 3 per cent, as happened in 2009. The coefficients of the minimum wage indicator in the employment equations are negative, albeit only weakly significant. In specification D a 1 per cent higher base-period share of minimum wage workers seems to induce a negative employment effect of –2.8 per cent, but the coefficient is significant only at the 0.073 level. The signs and magnitudes of the impact are similar in the other three specifications, too, but the estimates are statistically insignificant.

Coverage by collective agreement. Long-lasting experiments with the indicators at hand suggested that collective agreements did not have any measurable impact on the changes of wages in 2008–2009 but firms covered in both years of the crisis could maintain higher levels of employment. We do not observe such an effect with firms concluding collective agreements only in 2008 or 2009, but those having an agreement in both years had significantly better employment records: their advantage over uncovered firms amounted to more than 3 per cent in terms of staff numbers and almost 3 per cent in terms of total labour input.

Residual changes. Finally, we look at the correlations between the residuals of the employment and wage equations. The study of correlations is useful in clarifying whether firms firing a particularly high fraction of their employees could increase their wages by particularly high rates and vice versa. The

estimated correlations fall between -0.015 and -0.042 , calling into question whether there was a trade-off between employment and wages. Despite the low correlations in versions A, B and D the independence of the employment and wage equations is rejected by the Breusch–Pagan test. In evaluating these results it should be borne in mind that we lack information (as yet) on the size of the shocks hitting the observed enterprises; therefore, we cannot distinguish between movements along and shifts of the demand curve. This is a major shortcoming that calls for caution in the interpretation of the observed trade-offs.

While the effects identified in the equations seem to be small, on an individual basis, their combined impact on wages can be strong. Let us look at the case of two workers. Let Person A be a transportation worker employed by a firm with a relatively high share of older, skilled males and located in a “bad” region. Person B is a manufacturing worker in a good region and part of a predominantly young and unskilled female labour force. The estimated difference between them in terms of changes in their wages in 2008–09 (assuming one standard deviation difference in the continuous variables and making other variables equal) amounted to 5.3 per cent, with Person A being the loser.

3.5 | Vulnerable groups

The enterprise-level investigation could shed some light on the factors shaping employment and wage adjustment but is ill suited for the study of how different social groups were affected by the crisis. The analysis of the worker sample at our disposal extends beyond the limits of this chapter but we add one table on some vulnerable groups, which could be identified with the variables at hand. Table 7 looks at how the employment shares of part-timers, employees with fixed-term contracts, new entrants and working pensioners were changing and how their wages and working hours compared to their pre-crisis levels. Unlike firms, individuals cannot be followed in the WS, so Table 7.7 presents the changes of group means between May 2008 and 2009.

TABLE 7.7 | EMPLOYMENT, WAGES AND WORKING HOURS OF SELECTED VULNERABLE GROUPS, HUNGARY, 2008–2009

	Percentage change in the category's share in employment	Log wage change compared to the sample mean	Change in working hours (hours/month)
Part-timer	3.2	0.042	2.4
Fixed-term contract	-0.4	-0.007	-4.2
New hire*	-1.5	-0.074	-4.2
Working pensioner	-0.2	-0.093	-10.2

Note: *Hired in the previous year.

Source: The table is based on the data of 202,638 workers employed by firms in the panel and observed in either 2008 or 2009.

The share of part-timers increased markedly by 3.2 per cent in 2008–09. The fact that the average wage and average weekly working hours of part-timers increased faster than the grand mean suggests that many full-timers with relatively high wages and long working hours were shifted into the part-timer category.

The share of workers with fixed-term contracts and their relative wages did not change significantly but their monthly working hours fell by 4.2 hours or about 2.5 per cent. Firms in the panel hired fewer

new workers in 2008 than in 2007 and the relative wages and paid hours of the new entrants fell significantly, by 7.4 per cent and 4.2 hours, respectively. Finally, while the fraction of working pensioners did not fall, their relative monthly earnings fell by 9.3 per cent and their working time was shortened by 10.2 hours or about 8 per cent. Taken together it seems that workers' access to full-time jobs deteriorated and the marginal groups had worse than average records in terms of wages and/or working hours.

4 | Conclusions and policy issues

A first glance at the data from the early period of the financial and economic crisis suggested that the Hungarian labour market was hit hard by the contraction of export markets, the fall in domestic consumer demand and the cutting of budget expenditure. At the time of writing, public sector workers are likely to see a significant decline in their real earnings, while private sector employees have to face a significantly increased risk of losing their jobs and not finding another one.

Looking at firm-level data from the private sector we found that firms employing older skilled workers tended to cut wages and hours rather than staff numbers, while enterprises working with a young and unskilled labour force adjusted via dismissals. Male-dominated establishments had worse than average employment *and* wage records. We found only weak evidence of a trade-off between changes in employment (or total labour input) and wages.

Manufacturing industry lost a particularly high number of jobs, while trade and services tended to adapt by cutting wages. The wage gap between low and high unemployment regions grew wider.

We paid particular attention to some institutions which potentially prevented wages from falling substantially in response to the crisis.

First, both the individual and the firm-level data suggested that the *minimum wage* set a floor and had a marked impact on changes in wage distribution. Workers earning the base minimum wage or the mandatory floor for skilled workers were typically shifted to the increased level of these minima. Labour costs thus grew faster in the affected enterprises than elsewhere but we did not find evidence supporting that they lost more jobs. Our estimates seem to suggest that firms with more minimum wage workers had worse employment records but the respective parameter estimates were not significant at conventional levels. It seems that in the first year of the crisis the minimum wage could act as an anchor, and did so without a negative effect on employment.

Second, we found that coverage by *collective agreements* had no measurable impact on changes in wages. At the same time, we found that the continuously covered firms lost significantly fewer jobs – a major achievement in a period when private firms predominantly adjusted to the crisis by cutting employment. A small difference between the effects of collective agreements on employment versus total labour input hints that the covered firms responded to the crisis by hours reductions more than did their uncovered counterparts. Nevertheless, more time and data are needed, especially on profits and sales prices, to see the full range of consequences. The question of whether collective bargaining helped in distributing the burden of the crisis in the longer run and without incurring significant costs for customers is a question to be addressed in the coming years.

Third, the detrimental effects of declining real wages could have been mitigated by the state, at least in principle. In 2008–09, the Hungarian government was not in a position to preserve the real

value of public sector wages. In order to keep the budget deficit under control it had to choose between dismissing thousands of employees versus economising on wages, and the politicians clearly opted for the latter. A part of the savings was used to create publicly useful jobs, which added nearly 4 per cent to the stock of public sector employees in 2009. While the gross contribution of public works to employment was undisputedly considerable, the question of the net contribution free of deadweight loss and crowding-out effects needs further attention.

Overall wage inequity grew moderately between 2008 and 2009. Some of the changes we identified, such as the decline of earnings in high-unemployment regions, the cutting of working hours and wages of newly hired workers and employees with fixed-term contracts, as well as the falling wages of some low-wage industries tended to increase inequity. It seems, however, that these effects were almost fully offset by the shrinking wage advantage of older, skilled and male workers. If income inequalities grew during the crisis, as is likely to be the case, it must have been fed by growing unemployment and severe wage cuts in the public sector rather than wage adjustment within the private sector.

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Annex

TABLE 7.A1 | SELECTION PROBIT, HUNGARY

	Coefficient	Z
0–4 employees	–2.7848	–5.68
5–10 employees	–1.9286	–4.00
11–20 employees	–1.769	–3.67
21–50 employees	–1.8509	–3.84
51–300 employees	–.85846	–1.79
301–1000 employees	–.69464	–1.43
1001–3000 employees	–.32926	–0.64
Share of men	.1538	2.88
Average age	–.00047	–0.20
Average education (years)	.01730	1.38
Average hourly wage	.00001	0.71
Private	.42095	6.26
Foreign	.47443	6.17
Covered by collective agreement	.35004	9.84
Agriculture	.09483	1.36
Mining	–.01165	–0.06
Energy	.97353	6.18
Water & sewage	.25387	2.68
Construction	–.05672	–0.99
Trade	–.07521	–1.68
Transport	–.05737	–0.81
Hotels	–.11643	–1.42
Communication	–.10986	–1.11
Finance & insurance	.23845	2.31
Real estate	–.05503	–0.53
Professional services	–.17086	–2.03
Administrative services	–.25264	–3.41
Education (private)	–.57355	–3.88
Health (private)	–1.0271	–8.94
Culture (private)	–.28762	–2.26
Personal services	.11222	0.86
Log micro-region unemployment rate	.00119	0.05
Constant	.97675	1.91
Number of observations	9045	
LR chi2 (32)	2121.17	0.0000
Pseudo R2	0.1739	

Note: All explanatory variables relate to 20

Sample: 9045 firms observed in 2008

Dependent variable=1 if observed in 2009, 0 otherwise

TABLE 7.A2 | DESCRIPTIVE STATISTICS OF THE ESTIMATION SAMPLE, HUNGARY

	Mean	Std. Dev.
Log change of employment	-.0589783	.3784015
Log change of total labour input	-.0782148	.3898861
Log change of average gross monthly earnings	.0283779	.2095228
Share of men	.6019589	.3165387
Average experience	23.31242	6.788052
Average education (years)	11.69252	1.508497
1–10 employees	.2386231	
11–20 employees	.1454011	
21–50 employees	.1634031	
Fraction paid the minimum wages (base or skilled)	.2118956	.3054652
Collective agreement only in 2008	.0516909	
Collective agreement only in 2009	.0637735	
Collective agreement in 2008 and 2009	.1454239	
Foreign-owned	.1591808	
State owned	.0640893	
Local unemployment rate (log)	-3.027972	.6584917
Agriculture	.0567305	
Mining	.0060564	
Water & sewage	.031015	
Construction	.0891928	
Trade	.2214108	
Transport	.0492868	
Hotels	.0344209	
Communication	.0259178	
Finance & insurance	.0278357	
Real estate	.020035	
Professional services	.037005	
Administrative services	.0431778	
Education (private)	.0094634	
Health (private)	.0370379	
Culture (private)	.0123632	
Personal services	.0121107	

Source: Wage Survey

The Impact of the Crisis on Wages in selected EU Member States

8

Romania: Restrictive wage policies alongside poor crisis management

VALENTINA VASILE

1 | Introductions

Since 2000, Romania has experienced a period of economic growth, accompanied by significant labour market changes. These include a gradual shift to an active policy that targets job creation, stimulates competitiveness, encourages continuous training and reduces unregistered employment. Special attention is required to improve the matching of young people emerging from schools with labour market and business requirements. The Global Competitiveness Index reports that the Government is going through a transition from a focus on efficiency to an innovation-driven development model. Currently, Romania ranks 64, with a score of 4.11 in 2009–2010 (ranked 68 in 2008–09 and 74 in 2007–08: Global) (World Economic Forum, 2009). The main economic sectors in 2009 contributed the following percentages to GDP: agriculture 6 per cent, manufacturing industries 25 per cent, constructions 10 per cent and services 56 per cent (Romanian Statistical Yearbook, 2010).

Since the fourth quarter of 2008, the economic and social context has altered, as Romania underwent a complex and difficult evolution that consisted of recession, unemployment, lack of competition,

industry relocation further east, particularly of lighter manufacturing, and delayed social and education reform. The result has been a high level of informal employment and labour migration.

GDP in 2009 fell more than 7 per cent, which represented the largest GDP decrease among EU member states (see Table 8.1 for this and the subsequent analysis). This generated more than 300,000 redundancies – mainly in the private sector – and increased the registered unemployment rate from 4.4 per cent in the fourth quarter of 2008 to 7.8 per cent in the fourth quarter of 2009 and more than 8 per cent in first quarter of 2010. Wage increases in the first half of 2008 slowed down in the public sector, while in some industries in December 2009 they started to decrease in nominal terms after cuts in bonuses (NIS, quarterly press release on GDP).¹ The Government's anti-crisis reforms included: layoffs, reduced public sector wages and a smaller total gross nominal income in 2010 of 25 per cent. The level of GDP per capita in Purchasing Power Standards has been among the lowest in the European Union (EU) and second only to Bulgaria (EUROSTAT online database).² This trend continued in 2010.

TABLE 8.1 | MAIN ECONOMIC INDICATORS, ROMANIA, 2000–2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP real growth – 2000=100	105.7	111.1	116.9	126.8	132.13	142.6	151.5	162.6	151.0
Wage employees	4,619	4,568	4,591	4,469	4,559	4,667	4,885	5,046	4,774
Real wages – 2000=index 100	105.0	107.5	119.1	131.7	150.5	164.0	188.2	219.2	215.9
Unemployment rate (end of the year)	8.8	8.4	7.4	6.3	5.9	5.2	4.0	4.4	7.8
Inflation rate – Previous year =index 100	134.5	122.5	115.3	111.9	109.0	106.6	104.8	107.9	105.6

Source: NIS data. RSY Time series 1990–2009.

2 | General context before the crisis

2.1 | Vulnerability inherited from early transition

During the first transition decade 1990–2000, Romania experienced significant adjustments including privatization, economic restructuring and reintegration into external markets. The economy contracted dramatically, traditional markets were lost, employment fell and high inflation substantially eroded purchasing power. There were also major changes in the labour market: the development of a parallel economy, dual wage payments (including “envelope wages”), labour migration, unemployment and a drastic curtailment of living standards due to inadequate real incomes. Poverty increased to encompass one-third of the population.

The persistence of high inflation, low work incomes and rising unemployment were the main factors behind the holding back of domestic demand capable of leading to economic recovery. By the start of the new century, GDP was down by about 15 per cent and gross fixed capital formation indices exceeded

1 <http://www.insse.ro/cms/rw/pages/listaArhivaCom.ro.do>

2 <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsieb010>

by only a few percentage points the 1990 level (see Table 8.2 for this and the subsequent analysis). Low incomes and persistent poverty encouraged the development of a dual labour market where agriculture was turning into an alternative source of employment for laid-off industrial workers. Subsistence agriculture, temporary labour migration and the informal economy began to represent close to half of the number of employees in Romania not reflected in the official unemployment rate.

Following ten years of transition, the labour market situation appeared weak as workers were not paid on a performance basis and their incomes were kept low. One result was a significant increase in envelope payments and unregistered work.

TABLE 8.2 | MAIN ECONOMIC INDICATORS, ROMANIA, 1990–2000

	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP indices – 1990=index 100	87.1	79.43	80.62	83.76	89.7	93.9	87.5	83.3	82.3	84.02
Number of employees ('000)	7,574	6,888	6,672	6,438	6,160	5,939	5,597	5,369	4,761	4,623
Real wages – October 1990= index 100	81.5	70.8	58.9	59.1	66.5	72.7	56.2	58.4	57.0	59.4
Unemployment rate	1.8	5.4	9.2	11.0	10.0	7.8	7.5	9.3	11.4	11.2
Inflation rate – (previous year=index 100)	270.2	310.4	356.1	236.7	132.3	138.8	254.8	159.1	145.8	145.7

Source: NIS data. RSY Time series 1990–2009.

2.2 | Rapid economic growth before the crisis

The period of 2000–August 2008 witnessed a combined economic growth and continuing reforms, with the ongoing of privatization, a major withdrawal of the state from the economy and increased foreign direct investment (FDI). Furthermore, development strategies were drawn up, the functional market economy was acknowledged and Romania joined both the North Atlantic Treaty Organization (NATO) and the EU. Economic growth has been based on consumption and exports as economic and financial dependency on foreign capital ramped up and Romania emerged as an open economy, albeit strongly dependent on external markets. Domestically, inflation fell to single digits, remittances from those working abroad significantly exceeded the FDI level in 2004 and the exchange rate stabilized. As a result the business environment currently contains a preponderance of small and medium-sized enterprises (SMEs) representing more than 90 per cent of total enterprises from the private sector. The private sector was dominated by industry at about 72 per cent of GDP in 2007 and the remaining amount consisted of services and a declining agricultural sector. Constructions also expanded with investments in housing and national infrastructure, the latter including state financed highway projects.

Romania experienced a boom from 2003 to 2008 that overheated the economy and ultimately produced unsustainable imbalances. Real GDP growth was built on a consumer spending surge, facilitated by wage and credit growth and increased macroeconomic stability as the government overhauled the economy ahead of EU accession in 2007. Wages and disposable incomes rose quickly from a very low base. The growth in consumer spending was heavily debt-fuelled. There was also a rapid increase in domestic lending, although half of private sector loans were in foreign currency. At the same time inflation and interest rates were markedly down from 2003. In comparison to 2000, the shares of agriculture and

industry in GDP were also lower. These changes triggered significant changes in job demand with regard to occupations, trades and vocational training.

Robust export growth to EU countries reflected greater economic integration with western European economies. However, import growth rose even faster and generated an expanded current account deficit that peaked at 13.5 per cent of GDP in 2007. The overheated economy and rapid capital inflows complicated monetary policy and resulted in a credit growth averaging at an annual 50 per cent in 2006–2007. This impaired the National Bank of Romania's ability to hit its inflation target, notwithstanding interest rate increases and reserve requirements coupled with measures to slow credit growth. Fiscal policy was strongly pro-cyclical, with the government deficit rising from under 1 per cent of GDP in 2005 to nearly 5 per cent of GDP by 2008 (NIS data, RSY, time series 1990–2009).

2.3 | Crisis: increased imbalances and severe economic constriction

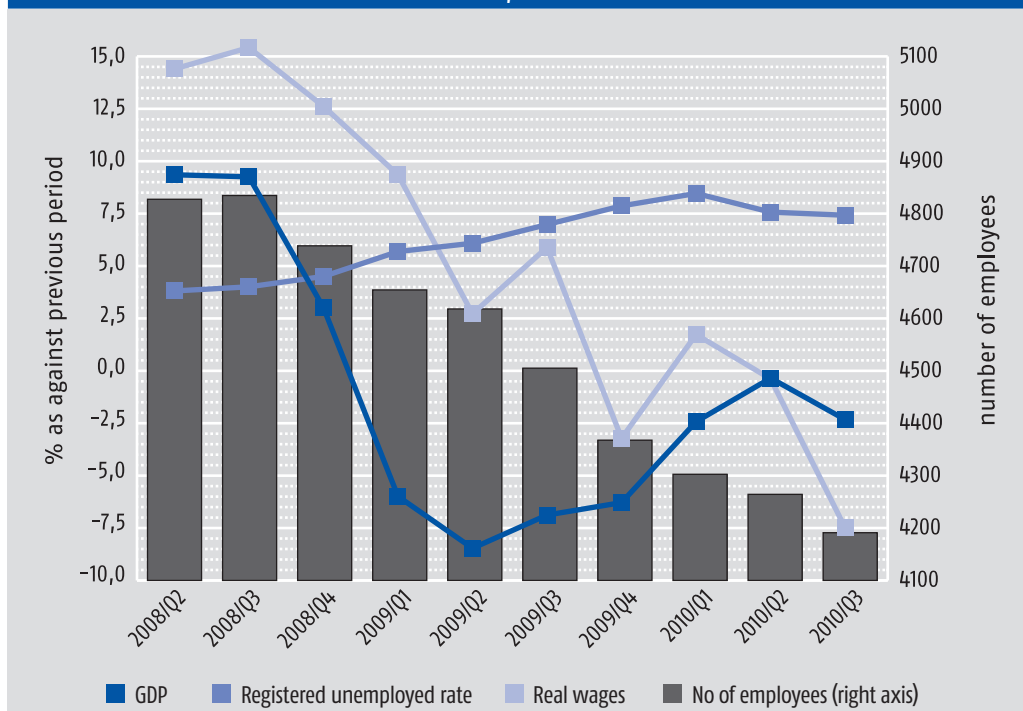
2.3.1 | A deep economic downturn

Recognition of the effects of the financial crisis on the Romanian economy was delayed given the financial system's low level of exposure to subprime mortgages. The Government's measures were slow to get off the ground, inconsistent, poorly coordinated, and inadequate in terms of supporting domestic demand. Faced with the problems generated by the crisis, the Romanian economy proved to be very fragile and the effects were more severe than anticipated. The poor management of the crisis was amplified by various disadvantages which prevented Romania from mounting a proper response and culminated in the following events:

- The marked previous growth was not completely sustainable, thus triggering significant falls in GDP that were deeper than the EU average.
- Central and Eastern Europe were turning into a high risk zone, with the contagion spreading from one country to another and the region experiencing a consequential drop in economic indicators, disinvestment by companies, higher unemployment, brutal adjustments in current account deficits and huge increases in fiscal deficits (National Bank of Romania, 2009).
- Demand for exports had decreased dramatically by around 14 per cent in 2009, with the trend continuing into first quarter of 2010 (NIS data, RSY, time series, 1990–2009).
- Loans were becoming more difficult to obtain due to wary investors and a credit rating drop below investment grade for Romania.
- The country was dependent upon foreign banking capital. The share in total bank assets with foreign capital in Romania was 88.3 per cent in 2008, 85.3 per cent in 2009 and 86.1 in the second quarter of 2010. Large shares of Romania's total foreign capital in 2009 were held respectively by Greece with more than 30 per cent, Austria with almost a quarter of the total and the Netherlands with around 12 per cent (National Bank of Romania, Statistical Bulletin).
- The share of the hidden economy as part of the total economy climbed as high as 23 per cent, according to official estimates (author's calculation based on quarterly AMIGO Survey, NIS). Informal employment expanded and had an impact on forecast earnings.

The contraction of economic activity has been much sharper than projected due to a combined unfavourable external environment and rapid retrenchment of domestic demand. Starting from an economic growth rate of 7.3 per cent in 2008 the Romanian economy plunged by 7.1 per cent in 2009 and continued to falter in 2010. In the first quarter of 2010, GDP fell by 2.6 per cent in comparison to the first quarter of 2009, and 0.3 per cent in comparison to the previous quarter (see Figure 8.1).

FIGURE 8.1 | GDP DYNAMICS DURING THE FINANCIAL AND ECONOMIC CRISIS, ROMANIA, 2008–2010



Source: National Bank of Romania data, Statistical bulletin (monthly) 2010.

The most significant decline in activity was registered in the second quarter of 2009 in the following areas: agriculture, forestry and fishing (–9.1 per cent), industry (–7.3 per cent), constructions (–14.2 per cent), trade, cars and household items repair, hotels and restaurants, transports and communications (–11.4 per cent) and financial activities, real estate, rental and services to enterprises (–7.4 per cent). The compression of final consumption amounted to 12 per cent and household spending diminished by 15.0 per cent as retail sales fell by 20.6 per cent. Gross fixed capital formation was down by 13.6 per cent in the first quarter of 2009 in comparison to the fourth quarter of 2008 (NIS, quarterly press release on GDP)³ and these developments highlighted the delayed impact of the crisis on the Romanian economy and domestic business's limited response.

In 2010, GDP fell by 2.2 per cent according to official estimates. In the December survey for the same year, the estimates reported a slight decrease in manufacturing and domestic trade, a significant contraction in construction, but relative stability in services. With regard to employment, a drop was estimated to be more significant for enterprises with 500 or more employees (–15 per cent). A more sharply decreasing trend was found for the following activities: the steel industry (–39 per cent), vehicle manufacturing (–38 per cent) and coke products and products obtained by oil processing (–45 per cent) (NIS, press release, 2009).

2.3.2 | Impact of the crisis on the labour market

Economic development in the transition period significantly affected the labour market, with major implications for its capacity to react. Employment participation dropped considerably. The crisis accentuated existing problems such as demographic decline while at the same time the business sector registered significant employment reduction following privatization and economic restructuring. Meanwhile, in the public sector, employment increased by more than 1.5 times to almost 1.4 million people. At the same time there was a lack of decent, well-paid new jobs in the private sector, a failure to balance supply and demand with regard to labour in the economy and the inefficiency of vocational conversion and training programmes. All of this boosted employment in the informal economy and irregular labour migration.

The crisis has led to important changes in the labour market from the perspective of social partners. These disruptions and atypical developments are hindering economic performance and obstructing recovery. Constricted economic activity has triggered both high private sector unemployment, and public sector layoffs – the latter arising from a strategy to reduce labour costs.

Budgetary corrections are now a regular occurrence in Government ministries and agencies where staff has been cut by almost half in order mainly to save money in areas like education, health care and research. Research allocations were reduced from 0.4 per cent in GDP in 2008 to under 0.2 per cent in 2009 and less than 0.1 per cent in 2010. The active labour market policy continues at an even lower level during the most recent period of economic growth, fluctuating around two per cent of the unemployment fund.

Employee participation in continuing vocational training has also decreased dramatically. Romania ranked last in the EU with its sponsorship of continuing vocational training courses which languished at around 1.3 per cent of total labour cost for close to three years.⁴

Investment in human resources was already low at the micro-level where vocational training expenditures represented 0.3 per cent of average labour costs per employee in 2008 and less than 0.2 per cent in 2009 (RSY, 2010) These practically ceased as personal allocations for continuing vocational training were restructured with the drop in labour income. Nevertheless, recent changes to the Act 76/2002 included the promotion of financial support for continuing vocational training in enterprises.

⁴ For the cost of continuing vocational training courses as % of total labour cost (all enterprises), see <http://appsso.eurostat.ec.europa.eu/nui/setupDownloads.do#>

2.3.3 | Intervention by international monetary institutions

To overcome the crisis, Romania contracted an external loan from international funding bodies totalling 19.95 billion lei, 12.95 billion of which came from the IMF and the rest from the EU, the World Bank and the European Bank for Reconstruction and Development (EBRD). The IMF and the European Commission have made the granting of the loan conditional on the Government implementing major labour cost cuts, wage reforms, wage reductions, government agency restructuring and public service staff reduction.

Among the EU's recommendations considered by the Romanian Government for 2009 were direct measures related to adjusting or moderating the effects of the crisis and to a lesser extent indirect measures for stimulating domestic demand in support of economic recovery. They included wage reductions for public employees, the reduction or cessation of some bonuses and other payments, unpaid leave and overtime payments compensation with time off. By 2010 there was a 25 per cent reduction in gross income. Government agencies were restructured with approximately 10,000 employees laid off. Only one in seven jobs opened up due to retirement of elderly employees or of voluntary resignation tendering.

A single wage law was established for public sector employees to standardize pay arrangements for job categories within the system (Framework law on the unified law on the wages of public sector employees, 2009 Act no 330/2009), and to control additional payments for wages and pensions in the public sector. Meanwhile, social contribution rates related to wages were restored to the level of December 2008, which cancelled the provisions of the previous government that reduced contributions to social funds as of 2009. These reductions were applied only in January 2009 and represented a decrease by 3.8 percentage points for contributions to the pensions' insurance fund.

Under the threat of losing their jobs, employees were compelled to ask for unpaid leave even if their working tasks remained unchanged. All staff expenditures – except for employees of state-owned companies and self-financed public entities – were reduced by 15.5 per cent, which corresponded to a cut in working hours equivalent to ten working days (0.3 per cent of GDP). Finally, overtime hours and premiums were suspended yielding a further decrease in expenditure of 0.1 per cent of GDP.

As of 1 January 2010, public sector employees were re-employed in accordance with the provisions of Framework Act No. 330/2009 for a system of unified or standardized wages in the public sector. In practice, the wage base included a series of permanent bonuses supplementing an individuals' pay as of December 2009. As a result, existing inequalities within the system were maintained. One problem is that each Government Ministry on its own without any coordination across the public sector decided to either eliminate some bonuses or temporarily suspend them. In practical terms, chaos in the hierarchy of jobs/positions increased and inequality became even more deeply entrenched over the long term despite important differences among wage bases for the same position or job within the same public institution. However, because of insufficient measures to efficiently manage the budget balance the granting of the third part of the IMF loan, valued at 1.15 billion euros, was made conditional on new enforceable austerity measures for a seven months period, starting in December 2010. The consequences of the measures are as follows:

- Public sector institutional structures, employment and costs were rationalized to provide permanent savings in the wage bill. The aim is to have employment reductions of 80,000 out of total of 1.3 million by the end of 2010 through a restructuring of the railways, education and health care, as well as standardized norms for personnel costs/type of activity in the public sector.

- Individual gross earnings were reduced by 25 per cent for all employees, except for those earning less than the minimum national wage of 600 lei per month. Furthermore there was a severe cut in housing benefit and another 25 per cent reduction in the individual gross incomes of employees of the National Bank of Romania, the Romanian National Securities Commission, the Private Pension System Supervisory Commission and the Insurance Supervisory Commission.

- All social security benefits were reduced by 15 per cent, including unemployment benefits and bonuses paid to unemployed persons who find another job. Payments are being made to employers for giving school leavers their first job.

A number of other complementary Government assessment measures have been implemented, including a VAT increase from 19 to 24 per cent and new personal taxes for the following items: gift vouchers, kindergarten vouchers, holiday vouchers, lunch tickets, social insurance contributions for incomes accruing from copyrights and interest on deposits/current accounts and term deposits. Also, there was increased taxation on housing of up to 200 per cent for people owning more than one house and a flat tax rate was introduced on earnings from capital market transactions.

These complementary measures were aimed mainly at individuals but the business sector has of course been strongly affected by the significant decrease in domestic demand for goods and services. Those most affected by the planned measures represent about 36 per cent of the Romanian population and include public sector employees (about 1.2–1.3 million persons), the unemployed (770,000) and pensioners (about 5.7 million). The main concerns are: (a) the diminished purchasing power of the population due to inflation, (b) the increased risk of unemployment and poverty, mainly among school leavers and c) a significant decrease of domestic demand for goods and services.

Almost two years after the first signs of financial crisis it appears that Government measures are still having only modest and perhaps even adverse effects and that an active support strategy for economic recovery has yet to be implemented.

3 | The general impact of the crisis

The financial crisis associated with the economic crisis has generated pressures on labour demand and supply. Lower demand for goods and services in both domestic and international markets continued to feed unemployment partially because of layoffs in wake of reduced business activity, bankruptcies and the return of emigrant workers from abroad – including those working in the informal economy and thus unable to receive unemployment benefit in their adoptive countries.

The country has also experienced increased household indebtedness and even higher rates of default. Incomes from labour have fallen, as have, implicitly, savings. In October 2008, the volume of personal bank deposits diminished by 3.5 per cent (4.7 billion lei) and for the first time in the past four years net withdrawals were recorded (National Bank of Romania, Statistical Bulletin, 2010).

Furthermore, the Romanian economy seems unattractive to foreign capital, and Romania seems to have moved to the periphery of investor interest. Foreign direct investment in 2009 totalled 4,899 million euros, about half of what it was in 2008 and the trend has continued in 2010 – in the first quarter

of 2010 FDI represented only 754 billion euros, half of its level in the first quarter of 2009 (National Bank of Romania, Statistical Bulletin, 2010).

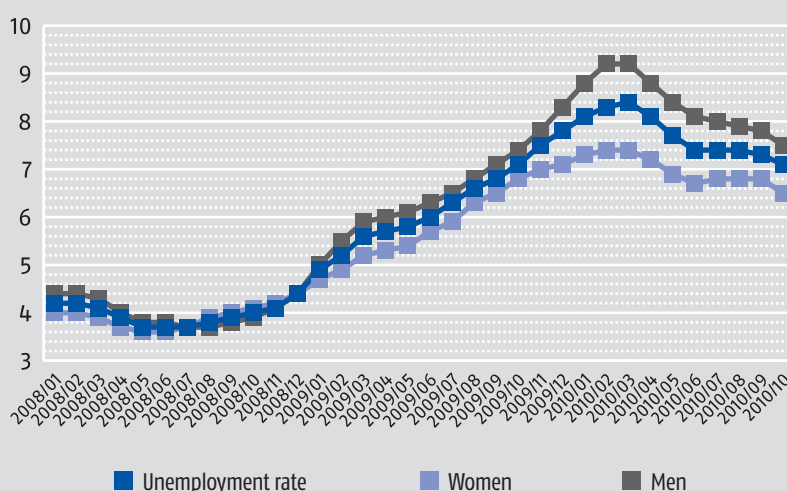
The anti-crisis measures were implemented to stimulate the economy but they have had little effect so far. These included the “first house” programme and temporary and partial subsidies of wage costs in the hiring of the unemployed or, in particular, persons with disabilities. The Government’s enforcement of even minimum taxation has led to bankruptcies among small and medium-sized enterprises. The elimination of the micro-enterprises category by taxation authorities in the Government also triggered mounting administrative costs for those companies directly affected by the decision.

There was a noticeable decline of remittances from Romanian workers abroad of about three billion euros in 2009 or 50 per cent of the 2008 level (BNR, payment balance, 2010). This trend has also continued in 2010 and put pressure on household members remaining in the country to seek jobs and other new sources for increasing their incomes. The result was unfavourable, decreasing wage levels on local labour markets and the social security system for supplementary protection services (social assistance for poorer persons, for example).

Finally, the risk of poverty increased in Romania, being more marked in 2010 than in 2009. The World Bank estimated that absolute poverty rose in the country to 7.4 per cent in 2009 (World Bank, 2009). Close to 1.6 million people or one-third of Romania’s population are considered to be at risk of poverty. They include mainly young people between 16 and 24 years of age who have been even harder hit than pensioners.

One particularly striking consequence of the crisis in the labour market was the expanding number of people laid off from their jobs following diminished economic activity and disinvestment. In the fourth quarter of 2009, the registered unemployment rate stood at 7.8 per cent, and in first quarter of 2010, it climbed to 8.4 per cent or 765,300 (see Figure 8.2).

FIGURE 8.2 | REGISTERED UNEMPLOYMENT RATE, ROMANIA, 2008–2010
(END OF MONTH, %)



Source: NIS data. RSY, time series 1990–2009.

It was not all bad news. In the third quarter of 2010, the unemployment rate fell slightly, to 7.4 per cent. But there were no consistent signs of a complete recovery. The unemployment rate remains the highest among young people in the 15–24 years of age range – over three times the national average. Regionally, the highest jobless rate was recorded in the county of Vaslui in north-eastern Romania, at more than 15 per cent, in contrast to under 3 per cent in both Bucharest and the county of Ilfov. Also, the proportion of unemployed adults, aged 18–62 across Romania rose from around 3 per cent at the beginning of 2009 to 5.5 per cent in March 2010, and then dropped slightly to 4.9 per cent after June 2010 (NIS, Monthly Statistical Bulletin).

After March 2010, the registered unemployment rate decreased slowly, but not due to economic recovery or increasing re-employment. After the expiry of unemployment benefit entitlements some people remained registered in the labour force which meant that the statistical records reflect only a portion of those without jobs in the formal sector. Young people remain the most vulnerable to unemployment and the majority of new entrants have ended up in the informal unregistered sector, which is likely to become an established refuge for them. In addition, employment precariousness increased markedly with some jobs remaining part-time or temporarily suspended.

Long-term unemployment predominantly affects the youngest and oldest (over 55) age groups. The difficulties involved in reversing the trend towards an expanding long-term unemployment and widespread labour market “informality” are demonstrated by the urban to rural migration and the return of migrant workers from abroad. All these negative factors are contributing to sustaining the crisis over the long term with significant social hardship.

The limited capacity of the economy to respond is reflected in the falling vacancy rate from 1.27 per cent in the first quarter of 2009 to 0.57 in the third quarter of 2010. The effects of the crisis vary by region, with the highest vacancy rates of more than 50 per cent registered in north-eastern Romania and the Bucharest-Ilfov regions (NIS, Press release, 2010).

In our opinion, in Romania job losses caused by the output downturn have only just begun. Wage employment continues to decrease; in the past year, it has fallen by around 315,000 – 7 per cent lower at the end of August 2010 in comparison to August 2009. The total employment in the country in August 2010 was 4.25 million and by October it had continued to decrease to 4.16 million persons (NIS data, Statistical monthly bulletin). The full breadth of the impact of the crisis on the labour market was witnessed in the second semester of 2010. The country had recorded significant job losses in commodity production and export-oriented sectors including tourism. Some of those out of work were moving back to rural areas or taking up informal jobs in urban areas. A reversal in rural-to-urban migration flows could be expected in the future as a consequence of formal job losses in export-oriented sectors, such as the metal industry and machine building.

Nominal net average monthly earnings were 1,477 lei in December 2009, which stabilized during the first quarter of 2010 as a result of the 13th wage payment in the previous year. Following that there was a continued and significant decrease in earnings to a monthly level of 1,340 lei in October 2010 (NIS, Monthly statistical bulletin, 2010)

The highest increases in net average earnings were recorded in the sector of products obtained from oil processing (5 per cent). In contrast, wages decreased the most in financial intermediation (–5 per cent).

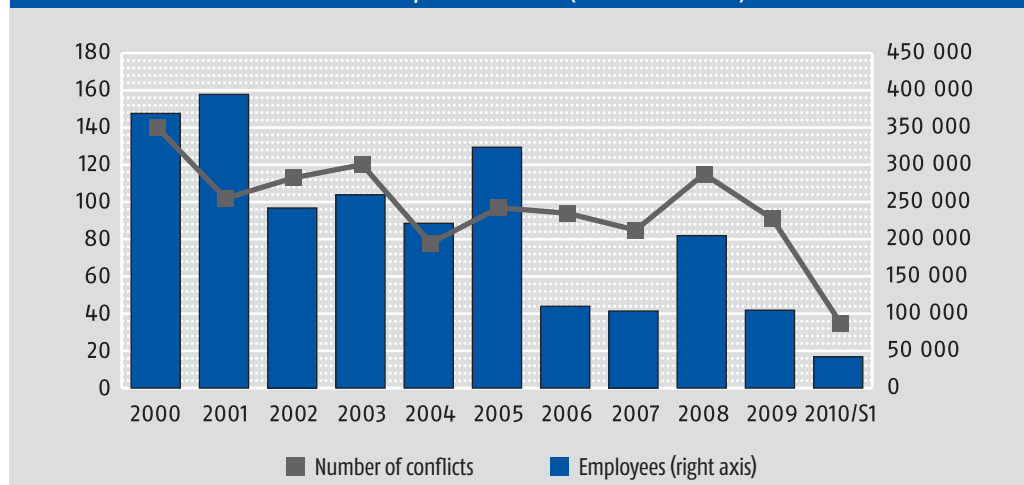
The impact of the crisis on the labour market beyond job losses has also led to rising informal employment and working poverty, which were already problems. After nine years when real wages increased by an annual average of 2.3, they started to fall in 2009 by 0.08 per cent and continued to do so in 2010 (NIS, RSY Time series 1990–2009). According to various estimates, the fall in real wages was driven by the private sector, especially by the processing industry, while wages in the public sector also started to be cut seriously in 2010.

In January 2010, the minimum wage in the public sector was supposed to increase up to 705 lei per month, in accordance with the new wage law governing public sector employees which came into force in January. The current minimum wage in the private sector remained at 600 lei per month. However, the new fiscal constraints laid down in 2010 have postponed such public sector minimum wage increase until the end of 2011. Meanwhile, the private sector minimum wage increased in January 2011 to 670 lei per month as a result of the negotiated single collective agreement at national level for 2010–2014. In the public sector it remained at its previous level of 600 lei per month, reflecting the new restrictive wage policy.

Public sector wages also fell due to the abolition of bonuses in 2009 and dropped even further, by 25 per cent, in the second half of 2010. This means that for some jobs the nominal decrease in total incomes was up to 60 per cent of the level registered in 2008. Despite a 15 per cent increase for 2011, the public sector wage level remained well below the pre-crisis level, both in nominal and real terms.

The combination of Government-initiated anti-crisis measures and layoffs in the private sector sparked trade union action for a brief period. In the latter part of 2008 industrial disputes were about 35 per cent higher than in 2007, before dropping off in 2009 (see Figure 8.3). What stalled them was the selective treatment within the public sector, respectively the measure of cutting wages by 25 per cent in public administration while no similar layoffs and wage cuts were applied at companies with majority or 100 per cent state ownership.

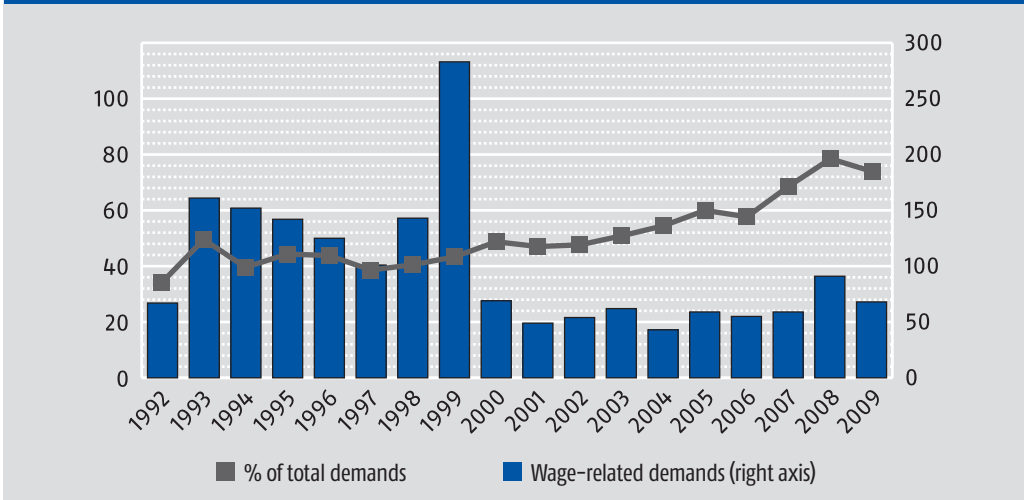
FIGURE 8.3 | COLLECTIVE LABOUR DISPUTES AND NUMBER OF EMPLOYEES INVOLVED, ROMANIA, 2000–2010 (1ST SEMESTER)



Source: Ministry of Labour, Family and Equal Opportunities. Quarterly statistical bulletin, 2010.

Wage negotiations with state employees at the national or local level, particularly in education and health, are conducted within the framework of a tripartite arrangement between the social partners. Minimum wage increases and wage adjustments are expected to take into account trends in inflation, and wage grid/scale to take into account the minimum national wage for public employees as a minimum threshold. Nevertheless, the conflicts generated because of wages increased significantly in 2008. (see Figure 8.4).

FIGURE 8.4 | CONFLICTS GENERATED BY WAGE-RELATED DEMANDS, ROMANIA, 1992–2009 (% OF TOTAL CLAIMS)



Source: Ministry of Labour, Family and Equal Opportunities, Statistical Yearbook, 2010.

Informal employment persists in Romania despite the continuous economic growth in the 2000s. Some experts suggest that informal employment now accounts for between 20 and 50 per cent of total jobs in Romania and would continue to be mainly influenced by the following factors: increased taxation of wages, poor social services, insufficient employment opportunities due to lack of education, poverty and discrimination against specific minority groups such as the Roma. Very often, school graduates accept temporary employment in the informal economy as a transitory step toward a suitable job, with a “remunerative” level of wages.

The unions estimate that employment in the informal economy is widespread and makes up more than 30 per cent of the country's economy. The most recent official estimates place it at only 23 per cent of GDP in 2009–2010, with significant variations among different sectors (OECD, report on Romania, 2008).

Also, Romania has a higher share of people working simultaneously in both the formal and informal economic sectors, compared to their counterparts in Bulgaria, the Czech Republic, Slovenia and Hungary (Stănculescu, 2006). At 23 per cent, Romania has the largest number of people in the EU receiving envelope wages (that is, informal cash distributed “under the table”) (Eurobarometer data, EC, 2007). The extent and dynamics of informal employment are strongly linked to the necessity of a second job in wake of

low earnings in formal economy jobs. The need to supplement regular incomes is the main reason why the self-employment in the past decade has accounted for 20 per cent of informal employment. The crisis has exacerbated this situation.

4 | The impact on wages

In the most recent period wages have clearly been under pressure due to financial restrictions in the public sector, but also the shrinking of the domestic market for goods and services and the decline of exports. At the same time, wage earnings represent more than half of total household incomes, from 80 per cent if only one person is working in the family down to 33 per cent in unemployed households and 20 per cent in pensioner households.

4.1 | Wage fixing mechanisms in Romania

Since 1991, wages have been determined on the basis of the individual workers' labour contract but also of collective agreements at company, sectoral and national level.

The last national collective agreement at the national level occurred in the period 2007–2010. Wage negotiations developed gradually in Romania and continue to be very much dependent on the enterprise's ownership, work category, union membership and bargaining power and the employer's and workers' representatives.⁵ Such negotiations, particularly in key sectors of the economy, have led to general price increases and may have represented a factor of labour market rigidity, and of the poor link between economic performance and wages. Some wage increases have failed to take into account economic performance and have markedly raised employee pay differentials among trades, professions, fields of activity and regions and may also explain why wages no longer reflect the experience, skills and performance of specific job categories.

The general bargaining framework at company level was defined up to 2010 by agreements concluded at the national or branch level, within a coherent multi-bargaining level system.⁶

However in practical terms, wage bargaining is concentrated at the branch and enterprise level and social partners are not always operating from equal positions of strength. Additionally, wage policy at the company level is also "adjusted" up or down according to prices, productivity and other measures of enterprise performance. However, over the years there has been an escalation of wage increases following a failure to control inflation and to reflect real performance.

In principle, the minimum wage is paid to the lowest skilled or unskilled employees at the firm. Until 1998, the minimum wage (but different wage levels) at company level corresponded to the standards

⁵ In addition to asymmetries of power between the social partners, levels of unionization differ greatly by region and sector, from as low as 1 per cent unionization in trade to 40 per cent in industry.

⁶ The enforcement of the provisions contained in collective agreements is based on the following: (i) the principle of extending provisions to all employees; (ii) the provisions at higher bargaining levels represent minimum thresholds for bargaining at lower levels (branch, group, enterprise and so on).

established by the Government. Afterwards, wider latitude was granted to companies⁷ to set their own wages – including by paying additional bonuses – as long as they guaranteed the payment of the minimum wage for full-time equivalent work.⁸

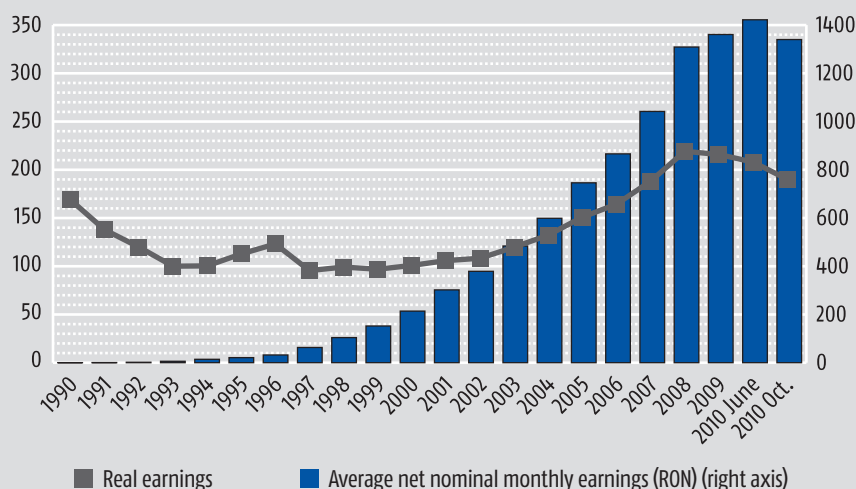
The bargaining mechanism for negotiating collective agreements, even if considerably improved, is still cumbersome and inefficient, especially with regard to wages. Moreover, SMEs in Romania represent more than 99 per cent of active businesses, and only around 7 per cent of them have more than ten employees. The modest size of employers makes it difficult to enforce the provisions of national collective agreements, even though statutory coverage should be 100 per cent. Unions are also poorly represented in private companies, while employers' organizations tend to be passive about governmental resolutions, especially since they do not seem to have much power to influence decision-making, as demonstrated by recent negotiations regarding the laws of education, institutional reform, public sector wages and pensions. This diminishes the attractiveness of unions for private sector workers, especially among the youth.

4.2 | Rapid wage growth before the crisis

Average net nominal monthly earnings in lei increased considerably in Romania between 1990 and 2009, from 0.34 lei per month in 1990 to 1,422 lei per month in 2010 (see Figure 8.5). This was triggered by the following factors: inflation, rising labour productivity, changes in the hierarchy of trades and other occupations, emerging new jobs, economic restructuring, shifts in the importance of certain economic activities and changes in the proportion of low skilled or manual jobs versus higher skilled jobs.

⁷ The guaranteed national minimum wage is the responsibility of the Government, and applies to all employees. It constitutes the starting basis in wage bargaining, and ensures – at least theoretically – a certain subsistence minimum, as a rule, what is regarded as economically feasible during a given period. In the bargaining process, it is considered as a lower threshold or an initial amount with regard to setting wages for full-time employment equivalent to 170 hours per month. The settlement of the minimum wage is done by Government Resolution, after consultations with the trade unions (<http://www.mmuncii.ro/ro/statistici-55-view.html>). Minimum wages with regard to particular trades and occupations are settled at the sectoral level through bargaining between the social partners. These have limited application and ensure a minimum level with regard to general and particular needs of the trade or occupation. Also, at national level, coefficients related to the minimum wage are used to determine the minimum thresholds for wages at particular levels of training (for instance, the minimum wage for a secondary school graduate should be at least 1.2 times the minimum wage of an unskilled worker; for employees with a higher education the coefficient is 2). The purpose of these minimum thresholds is to allow equitable wage differentiation, especially for graduates.

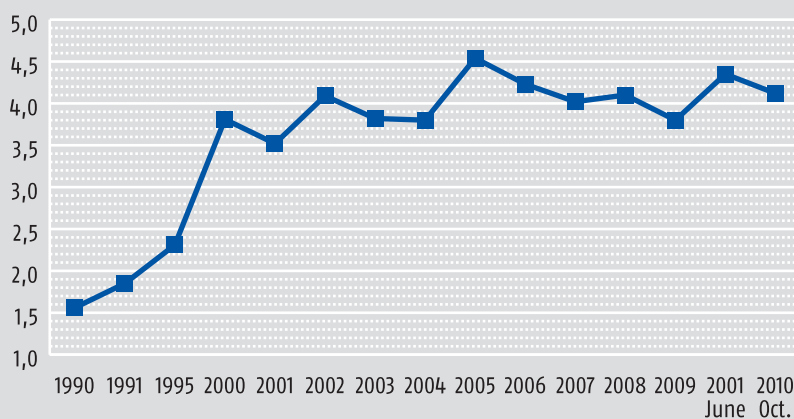
⁸ "Imposing a wage base on employees in individual labour contracts below the level of the official minimum wage constitutes law infringement" and the individual labour contract is not registered at the Local Labour Inspector's Office. At the same time, the legislation on setting the national minimum wage stipulates that "the level established does not change the wage-related rights existing at the date of enforcement of the present resolution, as established by collective agreements, individual labour contracts or other normative deeds, depending on the level of the minimum gross wage at national level."

FIGURE 8.5 | MONTHLY NOMINAL WAGES AND REAL WAGES, ROMANIA, 1990–2010

Note: 2000 = 100.

Source: NIS data. RSY Time series 1990–2009.

The differences among industrial wages are significant. The ratio between the highest and the lowest average wage by activity increased from 1.6 to 3.8 times between 1990 and 2000 and up to 4.3 in June 2010 (see Figure 8.6). Until 2000, the highest earnings were recorded in mining, but thereafter it occurred in financial intermediation. The lowest earnings over the whole period were in hotels and restaurants.

FIGURE 8.6 | MAXIMUM/MINIMUM AVERAGE NOMINAL MONTHLY EARNINGS, BY ACTIVITY ROMANIA, 1990–2010 (CANE REV. 2)

Source: NIS data. Author's calculations based on RSY Time series 1990–2009.

Average wages are calculated from the sum of the basic wage and various supplements, such as bonuses and other wage complements. The latter are subject to a range of criteria: importance of the industry (hierarchical coefficients for public sector), fidelity, and length of service, overtime including during holidays. On average, bonuses at the national level do not exceed 20 per cent of total wages, but differences among business activities are more significant, ranging from 2.9 per cent in hotels and restaurants to 39.3 per cent in public administration and 41.7 per cent in extractive industries (NIS data).

Among individual wages the disparities are also very high, depending, for instance, on whether the employer is a foreign multinational or a Romanian enterprise.

Labour cost development became to some extent independent of wages during the first transition decade following socialism when new contributions were imposed (contribution to the unemployment fund) or the existing ones increased (for healthcare, for pension, income tax). The result was that the fiscal burden on wages increased to 45 per cent in 2001 and hovered around 41 per cent in 2009 (author's calculation based on legislation in force at respective years). Nevertheless, labour costs stayed relatively low, and hence represented an incentive for foreign investors.

In Romania, the share of wages in total household incomes is significant. During the period of economic growth (2000–08) disposable household incomes⁹ rose spectacularly by almost 10 per cent annually, although they still represented less than one-third of EU-15 average household incomes, and half of those of the ten new EU member states. In 2007, the average disposable incomes of Romanian households expressed in PPS were 5.4 times lower than the EU-15 average and 1.9 times lower than the ten new EU member states average (Comisia Prezidențială Pentru Analiza Riscurilor Sociale și Demografice, 2009).

These significant differences are due to imbalances in the employment structure, and reflect in particular the high proportion of informal sector workers. Also, one key factor is the relatively low level of labour productivity (2.5 times lower than the EU-15 average and 1.5 times lower than the average in the ten new EU Member States), and the inefficiency of important sectors of the economy especially agriculture.

An important wage issue in recent years is the increasing volatility and inequality among incomes and sources of income and the distortion of income distribution in terms of deciles (see Figure 8.7).

9 The largest share of incomes is used to cover basic needs, the share of expenditure on food exceeding 40 per cent of total expenditure.

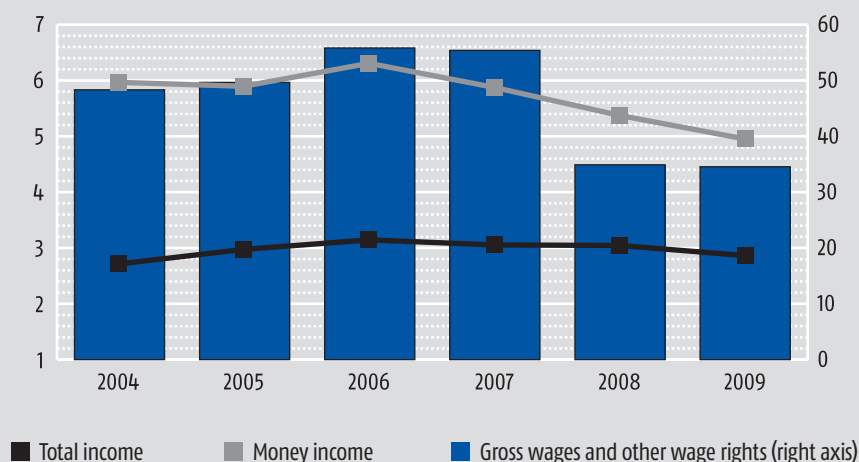
FIGURE 8.7 | WAGES AS A SHARE OF TOTAL HOUSEHOLD INCOMES (BY DECILES), ROMANIA, 2007–2009 (IN %)



Source: NIS data based on Household Survey, RSY, 2008, 2009 and 2010.

Disparities of income in Romania increased after 2004 with higher incomes growing faster than low incomes (see Figure 8.8).

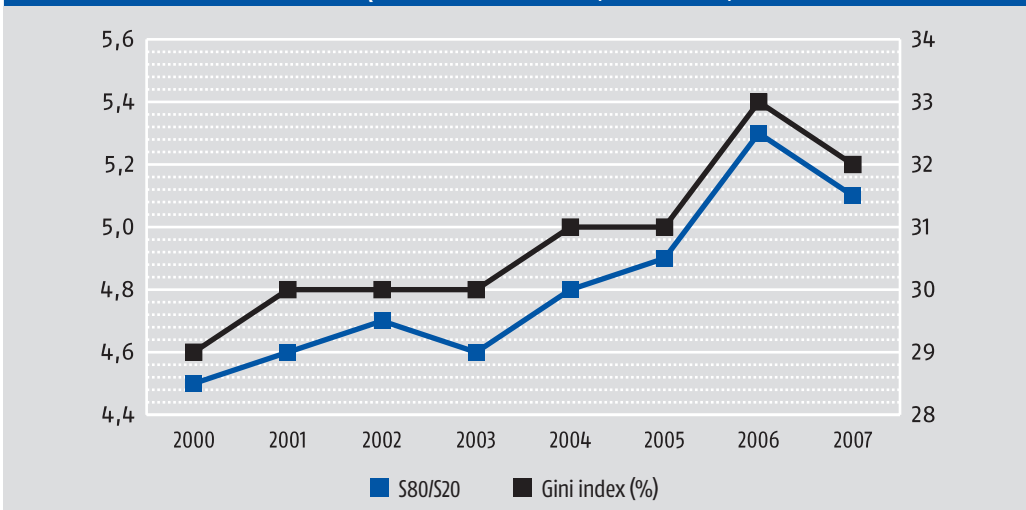
FIGURE 8.8 | RATIO D9/D1 FOR TOTAL INCOMES, MONEY INCOMES AND WAGES, ROMANIA, 2004–2009



Source: NIS data, RSY, 2008, 2009 and 2010.

In 2007, the total disposable income of the “richest” quintile was 5.3 times higher than that of the poorest quintile (4.9 for EU-15),¹⁰ while the Gini coefficient was 32 per cent (30 per cent in the EU-15 and NMS-10 countries) which reflected an economic growth that did not benefit those on low incomes (Kakwani, Khandler, Son, 2004) (see Figures 8.9 and 8.10). This unequal development of incomes led to an increase in relative poverty, by 1.4 percentage points in 2007 in comparison to 2000.¹¹ Nevertheless, at the same time, absolute poverty decreased significantly, from 35.9 per cent to 9.8 per cent (NIS data and MLFSP).¹²

FIGURE 8.9 | INEQUALITY OF INCOME, ROMANIA, 2000–2007



Source: RSY Time series 1990–2009.

Eurostat data reflect a much more severe situation.¹³ The share of the population at risk of poverty or exclusion for Romania was 45.9 per cent in 2007 and 44.2 per cent in 2008 compared to 24.9 per cent and 24.5 per cent, respectively, at the EU level. By 2009–2010 the situation had got even worse (Eurostat online database, various years).

Jobs remain the main instrument for reducing poverty, although the current employment model seems to generate a relatively high rate of poverty among the employed population (see Figure 8.10). Income distribution is concentrated at low and very low wages and the level of the minimum wage is set in the vicinity of the poverty line. This is why the situation improved in 2006–2007, when the level of the minimum wage exceeded the poverty threshold by about 9 per cent in 2007.

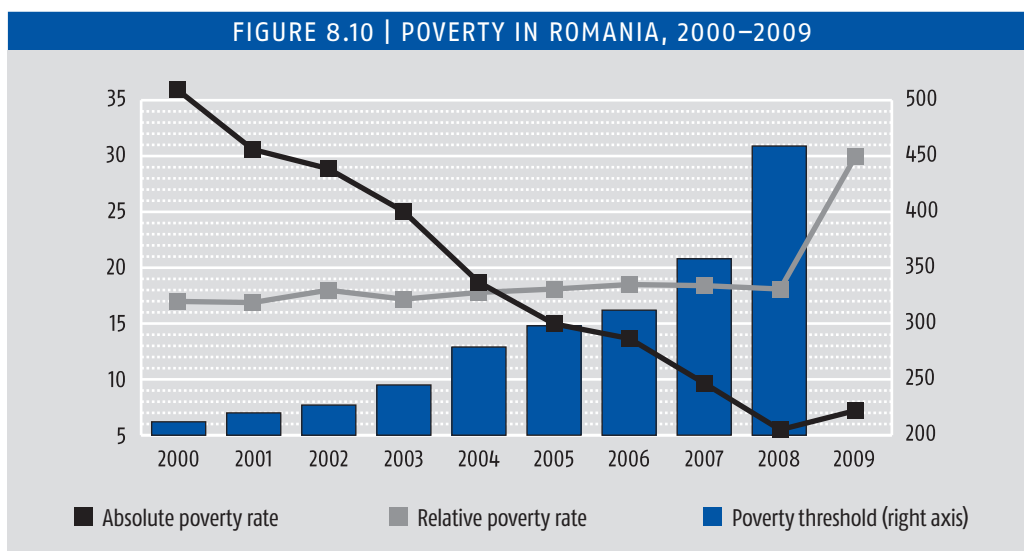
¹⁰ The ratio between total incomes in the lowest and top 20 per cent in terms of disposable income (S80/S20).

¹¹ 60 per cent of median income (EUROSTAT method).

¹² Raport de cercetare privind economia Sociala in Romania din perspectiva europeana comparata (Research Report on Social Economy in Romania from EU comparative perspective), pg 47, <http://www.mmuncii.ro/ro/studii-si-rapoarte-43-view.html>

¹³ See: Population at risk of poverty or exclusion, Eurostat, http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do?sessionId=9ea7974b30e8e5dd0dc5555146f299e5bd6894b47ee3.e34Sbxi0chiKc40LbNmLahiKb3uQe0?tab=table&plugin=1&pcode=t2020_50&language=en [01 Apr. 2011].

There are also significant territorial differences in incomes from work that reflect a different employment structure by region, with for instance the preponderance of agricultural activity being a source of employment and greater incidence of poverty in the north-east, south-east and south-west Oltenia.

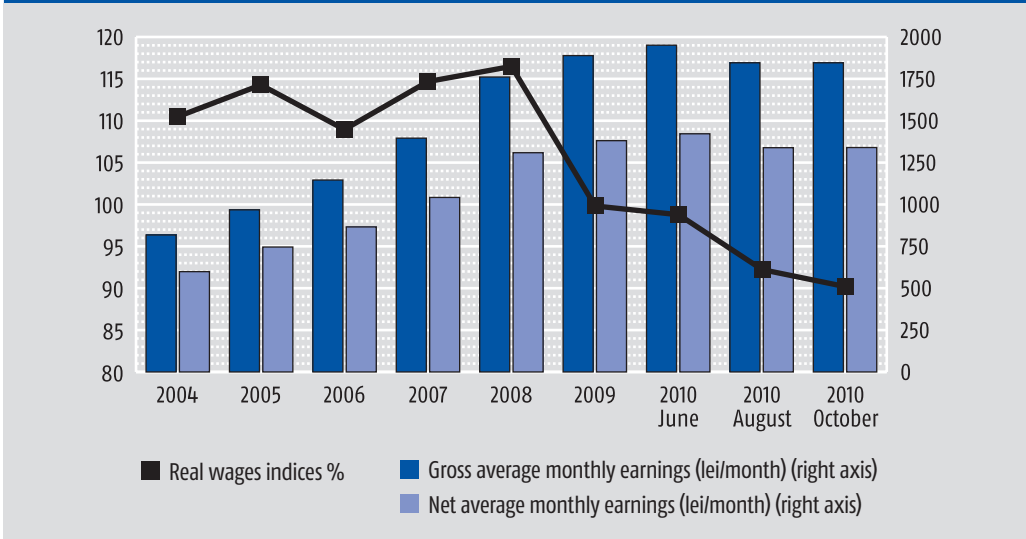


Source: Comisia Prezidențială Pentru Analiza Riscurilor Sociale și Demografice, 2009, estimates by specialists – no official data are yet available.

4.3 | Wage policy effects of the crisis

4.3.1 | Real wage decrease

In real terms, average wages had increased by about 30.3 per cent by 2008 as compared to 1990, in two different periods. In the first period, wages had fallen by 56.2 per cent by 1997 as a result of increasing inflation, restructuring and a strict wage policy. In a second period, mainly from 2000, following economic stability and also emerging private enterprises, wages started to increase rapidly, a process that continued until 2008. As a result, the purchasing power of net wages doubled between 2000 and 2008. The annual real wage growth rate between 2000 and 2008 was 19.8 per cent, higher than the average rate of other EU countries (4.4 per cent) and even of new EU members (7 per cent) (RSY Time series 1990–2009) (see Figure 8.11).

**FIGURE 8.11 | NOMINAL AND REAL AVERAGE MONTHLY WAGES, ROMANIA, 2004–2010
(IN % OVER PREVIOUS YEAR)**

Source: NIS data RSY Time series 1990–2009, for June, August and October 2010 real wage indices were calculated as against the corresponding month in 2009.

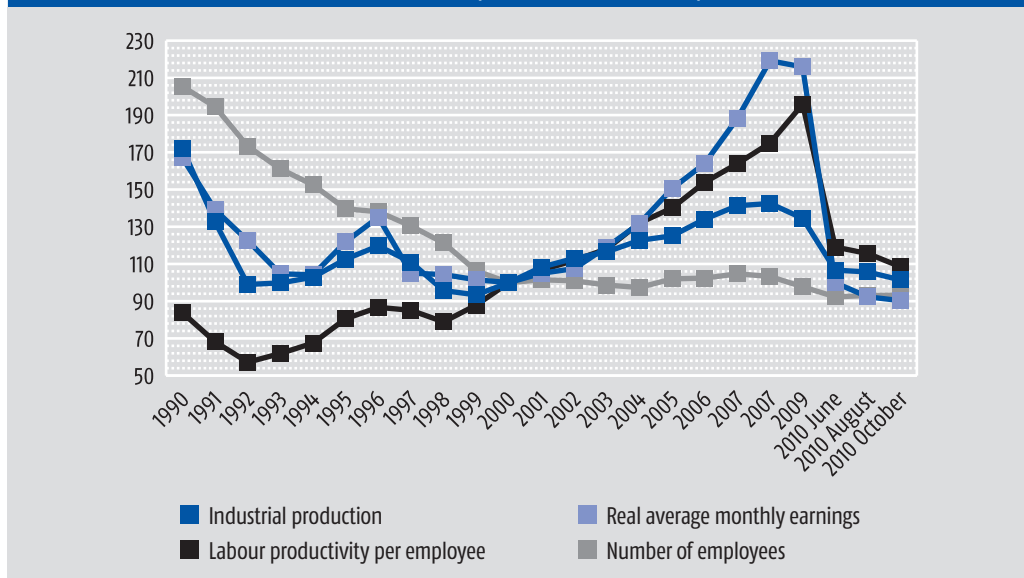
Real wages and labour productivity were relatively correlated in the period 2000–2004, and thereafter wage growth started to exceed productivity. Most significant wage increases occurred in state-owned companies where union density was high (see Figure 8.12).

But this did not last. In 2009, real wages in the private sector fell due to falling nominal wages alongside declining economic activity. Public sector wage reductions had developed out of compulsory unpaid leave and the elimination of bonuses. Additional restrictive measures in 2010 in the public sector again generated sharp decreases in pay. In the first two months after the enforcement of Law 118/ 2010 regarding some measures for reinforcing a balanced state budget,¹⁴ the average net incomes decreased by 25 per cent in education, 20 per cent in health care and social assistance and 13.9 per cent in public administration.

14

http://www.dreptonline.ro/legislatie/legea_118_2010_unele_masuri_necesare_vederea_restabilirii_echilibrului_bugetar.php

FIGURE 8.12 | LABOUR PRODUCTIVITY AND REAL WAGES IN INDUSTRY, ROMANIA, 1990–2010 (2000 = INDEX 100)



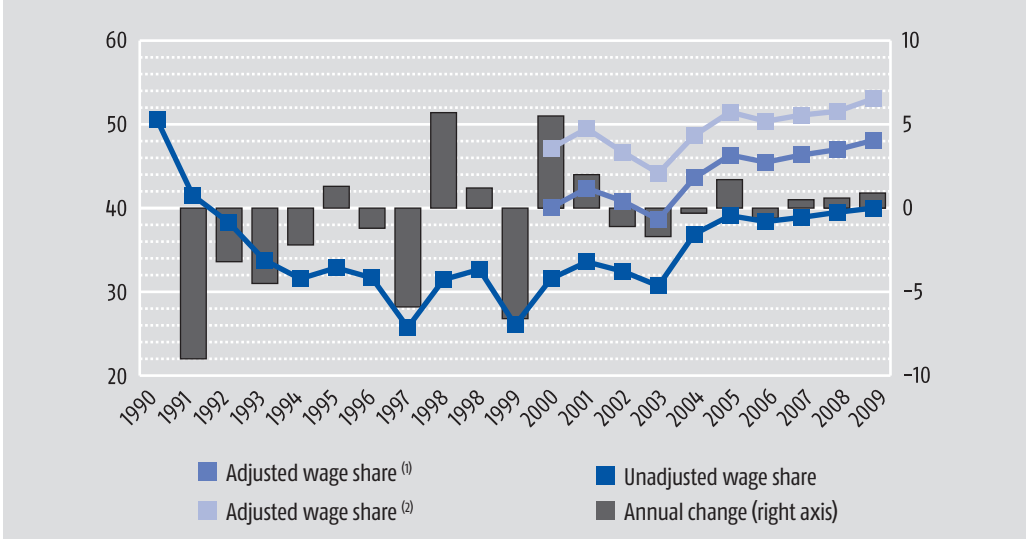
Source: NIS data. For June, August and October 2010 real wage indices were calculated as against the corresponding month in 2009.

The anti-crisis measures consisting of pay cuts in both the public and private economies have generated wage disparities and wage inequities that are more significant than what occurred in the 1990s. The crisis continued in 2010 (GDP decreased again with 1.3 per cent as against 2009). In the first quarter of 2011 against the fourth quarter of 2010, real GDP increased by 0.6 per cent (adjusted data – NIS, Press release 105/13.05.2011).

4.3.2 Wage share

In Romania, during the first decade of transition the share of gross wages and other payments in GDP decreased by half until 1997 in comparison to 1990 due to the poor indexation policy and restrictive wage increases (see Figure 8.13). After 2000, economic growth led to a slight increase of the (unadjusted) wage share in GDP, to 40 per cent in 2009 compared to 30 per cent in 2000.

FIGURE 8.13 | THE WAGE SHARE (UNADJUSTED), ROMANIA, 1990–2009



Note: Calculated total gross wages and payments as share of GDP (%); adjusted wage share (1) included self-employed persons; adjusted wage share (2) included self-employed and contributing family workers.

Source: National Accounts, Romania 2009.

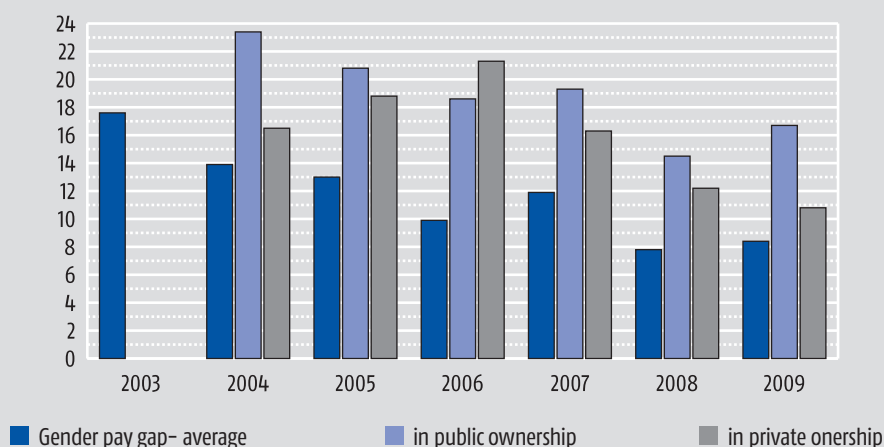
Within the crisis, low wages and diminishing wage employment should result in a new decrease in the wage share, as well as a further reduction in Romania's competitiveness and in its ability to respond to current challenges defined in the Europe 2020 Strategy (European Commission, 2010), such as increasing the proportion of skilled labour, ensuring sustainable economic recovery and curtailing poverty.

4.3.3 | Wage disparities

Even though gender discrimination is prohibited by law, in practice women are paid less than men, even for similar jobs, for a variety of reasons. These include the popularity of individual labour contracts and the traditional slotting of men and women in certain types of employment. Wage differences are higher in traditionally male dominated professions, where there is a demand for more training and responsibility while in the so-called female dominated service sector fewer training and overtime are required.

Nevertheless, in recent years, gender segregation has diminished as more women are hired in trade and more men are working in the service sector. The gender pay gap has shrunk, from more than 20 per cent in the first decade of the transition to 17.4 per cent in 2000 and then 7.8 per cent in 2008 before rising again slightly to 8.4 per cent in 2009 (see Figure 8.14). Men were paid more than women in state entities by about 14 per cent in 2008 and 15 per cent in 2009, compared to an advantage for men in the private sector of about 13 per cent in 2008 and 11 per cent in 2009 (NIS data. RSY Time series 1990–2009).

FIGURE 8.14 | GENDER PAY GAP, ROMANIA, 2003–2009



Source: NIS data. RSY Time series 1990–2009.

Men's average earnings are higher than those of women in the majority of economic activities. The largest differences were found in services (47.9 per cent in 2009), manufacturing industry (32.9 per cent in 2008 and 30.1 in 2009), financial intermediation and insurance (31.3 per cent in 2008 and 36.6 per cent in 2009), trade (25.6 per cent in 2008 and 21.7 per cent in 2009), hotels and restaurants (23.9 per cent in 2008), ITC (17.7 per cent in 2008), health and social assistance (17.4 per cent in 2008 and 14.9 per cent in 2009) and education (16 per cent in 2008 and 14.2 per cent in 2009).

In some activities, wage differentiation is increasing and in others it is decreasing. The discrepancy depends on the differentiated sectoral impact of current restrictive wage policies alongside economic reforms.

In October 2010, average gross wages decreased in real terms (the indices were 90.4 per cent against October 2009), with the highest wages found in financial intermediation (2.4 times higher than national average) and the lowest in hotels and restaurants activities (40 per cent lower than national average). Between 2004 and 2007 wage differences also increased. Large companies recorded lower pay differences because their wages were more closely linked to productivity and performance, and envelope payments were less prevalent. In medium-sized companies, wage differences rose significantly, especially in the case of women. But the gender pay gap seems to have increased in all types of enterprise: from 9.4 in 2008 to 9.9 per cent in 2009 in enterprises under 50 employees, from 5.1 to 6 per cent in enterprises with 50–249 employees, and from 12.3 to 13.6 per cent in large companies with more than 250 employees.

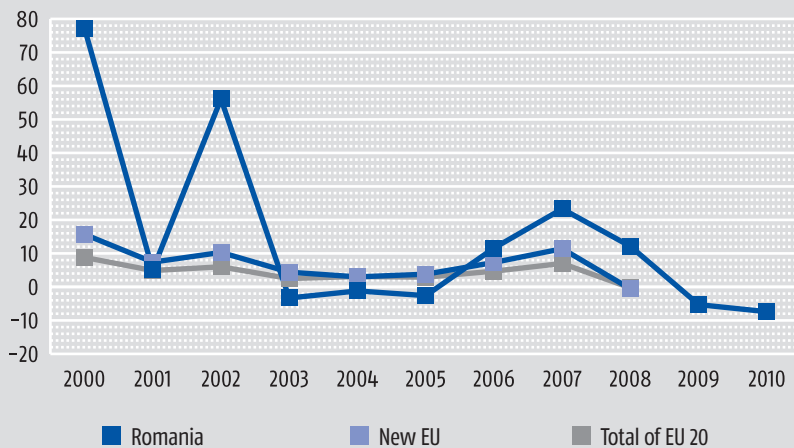
Workers' wages in some regions were also hit harder than in others, often reflecting their different levels of development of industrial activity and/or services. According to the available statistics, in recent years, the Bucharest-Ilfov region has the highest concentration of activities (economic, social, administrative and political) and also the highest wages. In addition, the territorial profile of wages is influenced less by the competitiveness of particular sectors or occupations than by relatively low migration leaving outside the region.

4.3.4 Minimum wage¹⁵

In accordance with the Labour Code, the minimum gross basic wage at national level is set by Government Resolution after consultations with the trade unions and employers' organizations. The level of gross national minimum wage does not alter the wage rights provided in collective agreements, individual labour contracts or other normative acts. However, employers are required to guarantee a gross monthly wage payment at least equal to the gross national minimum wage. As a result, when the national minimum wage rate is changed employers must increase all their wages accordingly. This can be a challenge for small companies and micro-enterprises where, bonus payment systems are underdeveloped or even absent. On the positive side, a larger minimum wage eliminates both the underpayment of workers and the proportion receiving "envelope" wages.

However, Romania stands out as one of the very few EU states with a minimum wage per hour below 2 euros. The statutory minimum wage per hour in Romania in January 2009 was 0.96 euros,¹⁶ followed by Bulgaria at 1.62 euros (WSI, Minimum Wage Database, 2009). The country's national minimum wage has tended to reflect the dynamics of the Romanian economy. The nominal increase in the minimum wage between February 2000 and January 2009 was 8.57 times and yielded a purchasing power, in real terms, 2.59 times higher – although still below the purchasing power level of October 1990. The increase of the minimum wage in the period 2000–2008 was 19.8 per cent per year, and was higher than in Bulgaria (8.2 per cent), the new Member States (7 per cent) and other EU countries (see Figure 8.15).

FIGURE 8.15 | REAL INCREASE OF THE STATUTORY HOURLY MINIMUM WAGE, ROMANIA, 2000–2010 (IN % OVER THE PREVIOUS YEAR)*



Note: *Minimum wage amounts compared on 1 January of each year. Real minimum wage calculations based on harmonized consumer prices. Source: WSI, Minimum Wage Database, 2009.

¹⁵ Substantial changes to Social Dialogue in Romania were introduced in 2011, please refer to the overview chapter for an update.

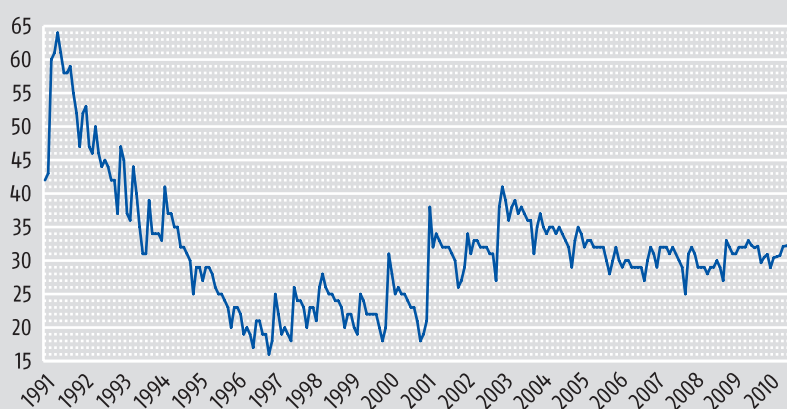
¹⁶ On 1 January 2009. Calculations in euros based on average exchange rate in 2008. .

According to Eurostat's online database, about 9 per cent of employees in Romania earned the minimum wage in 2002, and almost 10 per cent in 2005. In 2009, according to NIS, Labour Cost Survey 2009, 0.2 per cent of men and 0.3 per cent of women earned even below the minimum wage, while 4.6 per cent of men and 4.7 per cent of women respectively, earned the minimum wage. For 2010, on average, it is expected that the share of employees with wage incomes around the minimum wage will rise due to wage cuts in the public sector.

The ratio between the minimum and the average wage in Romania is lower than in many other EU countries. That ratio fell from 60 per cent in March 1991 to less than 20 per cent in 1996–97, the lowest value recorded in the country. By January 2000, the ratio was again below 20 per cent. However, after the minimum wage was raised from 45 to 70 lei per month the ratio increased to 31 per cent. Since 2000 the ratio has fluctuated around 30 per cent. Successive increases in the minimum wage, however, have failed to improve the ratio substantially because of the policy of “shifting the entire wage grid upwards” following minimum wage indexation.

In recent years, the minimum wage in Romania has averaged 30 per cent of the country's average wage, that is still below the European Council recommendations for a rate of at least 50 per cent. In March 2010, the country's minimum wage represented only 28.9 per cent of the average wage which was lower than in December 2009 (29.6 per cent) but higher than in December 2008 (26.9 per cent) (see Figure 8.16). “Wage reforms” have led to the revision of public sector wages and to the introduction of a new wage grid to guide the negotiations with social partners. However, the restrictive wage policy put in place has also led to a freeze of the minimum wage in the public sector, at 600 lei a month, so that the minimum wage should lose ground again with regard to the average wage.

FIGURE 8.16 | MINIMUM WAGES AS A PERCENTAGE OF AVERAGE WAGES, ROMANIA, 1991–2010



Source: based on NIS data. RSY, Time series, 1990–2009 and Monthly Statistical Bulletin 2010.

Gross wage distribution indicates a shift towards lower wage groups, with higher incomes accounting for around 5 per cent of employees. In the period since 2000, under conditions of economic growth, employees' pay has tended to converge on the minimum wage. In 2000 half of all employees

had earnings 12 per cent lower than the national average, while by 2007 the proportion had increased to 28 per cent. As a result, employees experienced a slow but constant process of relative impoverishment. The share of those at and around the level of the minimum wage remains significant (around 5.4 per cent in 2009).

The distribution of employees with regard to gross wages reveals a convergence on wages below 1,500 lei, both for women (among 62.8 per cent of them) and for men (59.6 per cent). A similar development was recorded in 2009 when around two-thirds of employees had incomes at or below the average wage. The low wage trap for a single person without children was 30 per cent (of total employed persons) in 2003–08, while for a single-earner couple with two children it increased from 17 per cent in 2003–05 to 28.2 per cent in 2008 (NIS, Labour Cost Survey 2009, and RSY time series 1990–2009).

5 | Improving wage policy to stimulate economic recovery

Government wage policy during the crisis has focused in particular on savings through cuts in wage expenditure, redundancies and temporary layoffs. The emphasis in the private sector has also been on layoffs, as well as on reducing or eliminating bonuses and other wage benefits in both individual labour contracts and collective agreements. The result has been a doubling of registered unemployment rate, from 4.1 per cent in 2007 to 8.4 per cent in the first quarter of 2010 (Monthly Statistical Bulletin, National Bank of Romania, March 2011).

For public employees the crisis measures that affected wages in 2009 were as follows:

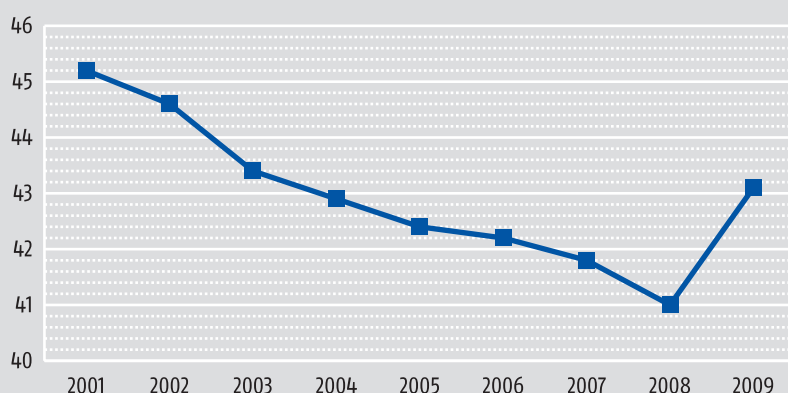
- For employees of state-owned companies with individual labour contracts, individual work contracts were renegotiated and, in some situations, layoffs were implemented followed by re-employment at lower wages.
- For the heads of government agencies wages were cut several times to establish a ceiling of 4,800 lei a month.
- Bonuses and other payments were eliminated or reduced.
- Overtime was no longer paid, but instead compensated with free time.
- The reduction of working time was recommended, as was the introduction of unpaid leave, equivalent to 10 working days for each employee.
- A 2010 unified law on wages was introduced for public sector employees.
- Budgetary allocations were reduced by 15.5 per cent through budgetary rectification, with some latitude left to employers within the ceilings laid down.

The Government in 2010 sought with its main measures to cut individual wages/total gross wage income by 25 per cent and extend the tax base by including other categories of income (copyright, for instance). This reduction applies to all wage brackets while freezing the minimum wage at 600 lei per month and keeping income tax at a flat 16 per cent. The unions had proposed progressive wage taxation instead, but the Government had repeatedly rejected this. Moreover, instead of full layoffs for 2010 some job positions were eliminated to allow wage increases of 15 per cent in 2011.

5.1 Wage-related tax reform

During the period of economic growth, the tax wedge (ratio of total labour taxes to total labour costs) registered a slow decrease due to the reduction of unemployment and health insurance contributions. In 2007, the tax wedge was 41.8 per cent and in 2008 slightly lower, at 41 per cent. According to the official statistics, the tax wedge decreased by 1.3 percentage points between 2004 and 2008. In 2009 the tax wedge on labour cost increased at 43.1 (Figure 8.17) and remains relatively constant for 2010 and 2011.

FIGURE 8.17 | TAX WEDGE ON LABOUR COSTS, ROMANIA, 2001–2009 (IN %)



Source: NIS data RSY, Time series 1990–2009.

Even though fiscal pressure on wages has diminished in recent years, employers consider that fiscal burden on wages is too high given the weak economy. In 2008, the tax wedge fell due to reductions in employee's contributions to unemployment and pension funds. But from February 2009, the new Government increased the fiscal burden as the contribution level was insufficient to cover pensions under pillar one (public, pay as you go). This increased fiscal burden resulted in employment shifts to the informal labour market or to temporary layoffs as forms of economic survival.

In the past two years the Government has failed to use income tax as an incentive to encourage people to move from the informal economy to formal employment. Instead, it has been mainly applied as a fiscal lever to obtain direct tax and short-term revenues. The failure to take advantage of active measures, such as lowered tax rates to stimulate employment, will only encourage people to continue switching to the informal economy. Moreover, the administrative measures for detecting and punishing informal employment are very inefficient. Tax holidays, bonuses for privileged public sector jobs and other measures associated with the postponed/exemption of taxed wage payments favouring large national companies have resulted in a significant revenue loss for the state budget.

5.2 | A plan for progressive minimum wage increases suspended

The social partners and the state signed a tripartite agreement¹⁷ for a medium-term minimum wage plan for 2008–2014. The parties involved acknowledged that the major problem in Romania is the economic and social gap that separates it from developed European countries and which is reflected in such indicators as GDP value per capita, the value of the gross average wage and the ratio of the minimum wage to the average wage”.

In 2008, the framework of the Tripartite Agreement was established for a gross minimum wage increase for the period 2008–2014. It planned a gradual increase in the minimum wage from 37 per cent of the average wage in 2010 to 40 per cent in 2011, 44 per cent in 2012, 47 per cent in 2013 and 50 per cent in 2014. The prolongation of the crisis modified the situation and the Government’s willingness to increase the minimum wage as agreed. For 2010, the unions were demanding a minimum wage increase to 705 lei, that would have represented a linear increase in the wage fund according to both inflation and labour productivity (Hossu, 2009).¹⁸ However, because of the economic crisis, the initial proposal of readjusting the minimum wage level in mid-2009 was reconsidered, so that it remained at 142 euros per month, and corresponds to only 30 per cent of the average wage.

5.3 | Wage moderation. Unified wage law for the public sector as an anti-crisis measure

The Government adopted a new law on unified wages for public sector employees at the end of September 2009. Accompanying anti-crisis measures negotiated with the IMF before the granting of a stand-by loan to Romania, the law was designed to harmonize wages in the public sector on the basis of responsibility, complexity of work and qualifications. However, the social partners who participated in the discussions were unhappy with the inclusion of a current coefficient grid which they consider failed to comply with the principle of equivalence for the main professions which had been determined during the negotiations.

The provisions do not apply to public sector employees whose earnings are above the minimum wage of 705 lei per month. Only wages below the threshold of 705 lei per month are permitted to have future increases. The rest of the public sector employees will see their pay frozen. One further aspect is that the law restricts the Government’s total public sector wage expenditure to a fixed proportion of GDP: 8.70 per cent in 2010, 7.97 per cent in 2011, 7.30 per cent in 2012, 6.70 per cent in 2013, 6.30 per cent in 2014 and 6.00 per cent in 2015. In principle, therefore – at least for 2010 – the Government has sought to reduce the public sector wage bill. In practice, the legislation is just a guiding “framework law” with a broad scope for further “additions” on an annual basis. Also, layoffs are being instituted to ensure that the spending ban laid down in the state budget is not violated.

¹⁷ See http://www.cnipmmr.ro/noutati/acord_tripartit.pdf

¹⁸ <http://stiri.kappa.ro/social/17-10-2009/sindicatete-au-cerut-oficial-majorarea-salariului-minim-la-705-lei-227996.html>

In conjunction, other structural changes are being made in the public sector to ensure that wages are competitive with equivalent wages in the private sector – based on data supplied by the National Institute of Statistics and other institutions and authorities. We saw in fact that public sector wages lost a lot of ground compared to wages in the private sector.

While an agreement has been reached with the social partners on the need to rethink the current public sector wage system, a debate continues on the job hierarchy in the public sector and the definition of equivalent professions and jobs to ensure equal pay for equal work and reflect the social importance of the given activities or work.

6 | Conclusions and policy issues

After 20 years of transition and successive reforms, wage policy in Romania has not yet developed into an efficient government instrument for improving labour performance or generating demand in the economy. However, the credit system has developed rapidly in recent years, and demand for goods and services is significant, particularly for durable goods.

Wage increases in the past, although legitimate from a social viewpoint, do not seem to have been sufficiently based on corresponding growth in labour productivity. The sectors where the unions are strong typically register higher wage increases both in specific trades and professions and in other job sectors. Some wage differences by sectors and professions are often arbitrary and cannot be justified on the basis of the qualifications of the employees involved.

The period of the crisis was not used as an opportunity to institute a better long-term balance between the need to sustain economic performance and employment – also in its qualitative dimension – and social outcomes, which can also help to generate domestic demand which is particularly important in a large country such as Romania. The anti-crisis measures were mainly centred on short-term-oriented and quantitative adjustments.

In particular, the following anti-crisis measures were taken:

- The fiscal burden on wages was maintained at the level of 2008, when Romania's highest growth during the transition was recorded.
- Various bonuses were reduced or even removed.
- Gross incomes were reduced for public sector employees by 25 per cent for the period July–December 2010 – not including employees of state-owned enterprises.
- Taxation was increased on incomes obtained exclusively from copyright by establishing an obligation to pay social contributions.
- The level of the gross minimum wage was frozen, despite a rapid erosion of workers' purchasing power due to inflation.
- Wage incomes were also reduced through compulsory unpaid leave.
- The application of temporary layoffs was facilitated for private companies to avoid insolvency or winding up for a period of three years.

At the same time, the future remains uncertain for the abovementioned new wage law for public sector employees that so far has been implemented only very partially in the wake of the extended crisis

and insufficient government financial resources. Poverty continues to increase and severe inequalities persist with major wage differences for the same job-type within public sector institutions. These outstanding problems may only contribute to prolong the crisis by failing to boost domestic demand for goods and services, while increasing the risk of poverty, labour migration, particularly of the young, and the increase of employment in informal labour market segments.

To date, the Government's measures have generated short-term effects – savings on wages due to compulsory leave, technical unemployment and so on – with a number of adverse outcomes on the social front. At the same time, the Romanian labour market remains extremely precarious, with low flexibility and an inability to absorb the unemployed, particularly the young. Nobody knows when wages will recover their economic and social functions.

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Annex



Conclusions of the ILO Subregional High Level Conference: The Impact of the Financial and Economic Crisis: Wage Fixing and Policy Responses¹ (Sarajevo, 5-6 November 2009)

1. The Subregional High Level Conference on 'The Impact of the Financial and Economic Crisis: Wage Fixing and Policy Responses' was organized by the ILO through its Subregional Office for Central and Eastern Europe and was held in Sarajevo from 5-6 November 2009. It responded to the request made at the 8th European Regional Meeting held in Lisbon from 9-13 February 2009 for more technical assistance on wage issues. Tripartite delegations from Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Kosovo², Montenegro and Serbia attended the conference, as well as observers from the International Organisation of Employers, the International Trade Union Confederation and other international organizations.

1 An earlier version of this volume was discussed at the ILO Subregional High Level Conference.

2 Within the meaning of UN Security Council Resolution 1244.

2. The importance of the ILO's Global Jobs Pact³ in proposing policies to mitigate the impact of the crisis was emphasized. The Global Jobs Pact warns against the threat of a wage and price deflationary spiral and points to social dialogue, collective bargaining and minimum wages as means to counter wage deflation.
3. The Conference addressed the impact of the crisis on wages and wage policy responses on the basis of reports by ten wage experts. The participants found that the crisis aggravated some weaknesses in wage fixing mechanisms and emphasized the need for governments, in consultations with social partners, to undertake fundamental wage reforms.
4. The current crisis has demonstrated the paramount importance of negotiated solutions in each country to recover from the crisis. Governments should play a more active role to stimulate and promote tripartite social dialogue, and engage with social partners more effectively to develop responses to the crisis appropriate to the countries' specific problems and needs.
5. The participants stressed the insufficient development of wage institutions. They also highlighted the fact that wage policy should figure more prominently on the policy making agenda considering its multiple effects on both workers and employers, and the fact that it remains the main focus of both collective bargaining and tripartite social dialogue. In this regard, the importance of having accurate, relevant and independent data on wages to enable such policies to be developed was stressed. At the same time, wages are only one part of an integrated, comprehensive policy framework which should also include non-wage areas such as taxation, social security contributions, etc.
6. Participants recognized that the objective of labour market institutions and their effectiveness were negatively affected by the large amount of economic activity taking place outside of the legal framework. Measures must also therefore be taken to reduce the informal economy.
7. Legislative provisions are needed in the wages area – for example, to avoid discriminatory wage practices and non-paid and/or undeclared wages – as well as effective implementation and enforcement. Implementation can be supported by awareness-raising of both employers and workers, training and information dissemination about existing legislation as well as increasing the capacity of labour inspection.
8. The participants agreed that there is a need to have a minimum wage as a wage floor to protect the most vulnerable workers, especially within the context of the economic crisis. Participants recognized that minimum wages are not at present fulfilling this role in the subregion as they remain below the subsistence level in some countries. There is still no minimum wage fixing mechanism in place in some countries. The participants agreed that the minimum wage should be fixed and adjusted, as indicated by Convention No. 131 (1970), according to both relevant social and economic factors, i.e. the needs of workers and their families and the cost of living, as well as productivity issues and employment maintenance etc. At the same time a number of constraints that currently put unnecessary pressure on the minimum wage should be removed, by consultation and negotiation with social partners, so that the minimum wage can effectively play its social and economic role. Examples could be to remove the automatic link between the minimum wage and public sector pay

3 Recovering from the crisis: a global jobs pact, Geneva, International Labour Office, 2009. http://www.ilo.org/public/libdoc/ilo/2009/109B09_101_engl.pdf

rates, and the link between the minimum wage and social benefits. Such reforms would also give more room for collective bargaining.

9. The participants also agreed that wages should be better linked to productivity. Productivity could be taken more into account in wage bargaining. Profit-sharing schemes and performance related pay could be negotiated.
10. The constituents agreed on the need for the government, in consultation with the social partners, to develop a more conducive legal and institutional framework in each country in order to strengthen collective bargaining. They also recognized that enhanced bargaining capacity on wage issues including greater access to relevant and independent information and data on wages was vital.
11. The countries of the subregion are no exception to the global situation and women receive lower pay for work of equal value than their male counterparts. Wage policies should address the gender earnings gap.
12. The participants welcomed the timeliness of the tripartite high level conference. They requested the Office to continue to monitor the economic and social impact of the crisis and provide further expert advice, technical assistance and training on the different aspects of wage policies highlighted at the conference.