Quarterly Report on Labour Market Developments and Policies – 4th quarter of 2008

Outline of quarterly developments in labour market indicators and policies

Contagion from the world markets has started to engulf the Romanian economy and labour market in the fourth quarter of 2008. These words are probably the most synthetic and truthful assessment of developments on the Romanian labour market and in the Romanian economy during the last quarter of 2008 and the first month of 2009. The fact that the spread of global economic malaise coincided with general elections on November 30th which brought to power a rather uneasy coalition made up of the former bitter adversaries, the Democrat-Liberals close to the incumbent President Traian Basescu and the Social-Democrats currently headed by the leader of the Senate, Mr. Mircea Geoana, did not make things look on the overall particularly easy.

This helped almost-worst case scenario to materialize. Caught in the midst of an election campaign, the outgoing liberal minority Government of Calin Popescu Tariceanu (currently in opposition-Feb.2009) did not manage to enact any coherent anti-crisis plan, apart o course, the commanding last ditch struggle to prevent a surge in teacher's salaries which, if enacted according to legislation hastily passed by the former Parliament, would have simply dissolved the already enfeebled fabric of the Romanian economy. Therefore, whatever measures were enacted and upon which we will insist more in the last chapter of this report, were unable to halt the spread of economic contagion.

Now it has to be explained that alike medieval epidemics and especially alike plague, economic contagion (see Shiller and Benedictow) of modern type spreads in what we call "metastatic/metastasis leaps". The occurrence of these leaps depends crucially on the size and degree of openness of an economy. The smaller the economy and the more open the more vulnerable to contagion and to its devastating effects. As in the middle-ages the most affected were small communities which could have been simply wiped out by an outburst of epidemic (e.g.: notably plague), in modern times, the most affected will be small, open economies, which would suffer to a disproportionate effect while simply lacking the means to defend themselves.

To this extent, the Romanian economy, with a feeble structure, not completely mended up after four decades of disastrous Central Planning and one decade of Transition is more than likely to get a heavy blow. Although data for the last quarter of the year have not yet been released completely it is more than likely that, on the year early, growth in the fourth quarter of 2008 will be only somewhere in between 2.5-2.8 and 5%. This is a still robust figure when compared to the developed economies but nonetheless down by 4.3 to 6.5 pp. from the record pace attained in the year to the third quarter and thus a clear sign of a marked slowdown which pushes the economy squarely back into negative Output Gap territory. Prices entered on a downward trend with their growth slowing towards 6% in the year to last December, a fact which in other times would have signalled good news taking into account the sharp bout that brought price increases on the year early to a all-time high of the last years of around 9% in July but which, given the global turmoil is yet another clear sign of the recessionary move. The exchange rate on the other hand which counts as the best measure of volatility on the Romanian market started to jitter as early as October last year. The National Bank tried to intervene though cautiously so as not to trigger a wave of *short* moves that could have depleted its reserves but did not manage to prevent a depreciation of the national currency against both the EURO and the US$, that for all purposes brought the exchange rate at around 4RON/EURO, exactly the threshold predicted by the national correspondent in its previous assessment (Q.Rep.Q3-08 RO). This rather sharp depreciation has prevented a further slow-down in price movement as domestic demand plummeted. However, it also served as to further highlight the dual risk faced by emerging markets, stemming both from economic slowdown as well as from capital flight (the main cause of depreciation) a fact that puts severe limitations on the intervention possibilities of Governments and thereby increases tremendously the vulnerability of these economies to contagion. In contrast with the developed markets where the inflationary path out of recession (including via quantitative easing) is a ready and available option, for these economies this makes hardly an option as it would trigger a collapse of their currencies and as such cause a complete meltdown.

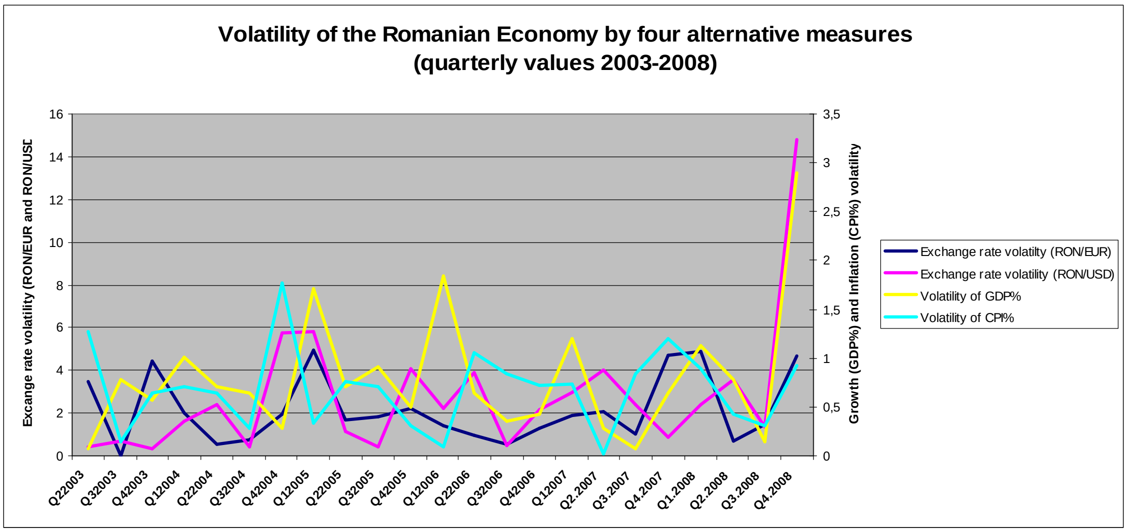
On such a background the pains of the labour market could have been only on the rise. Automotive industry represented mainly by the DACIA-RENAULT factory in Pitesti (114 km NW of Bucharest) has been practically closed for most of November and for the full length of December and the first decade of January. Large petrochemical plants like the AZOMORUES (in the Central region of Romania) and the OLTCHIM (in the more rural and poor South West) have also closed or seen their activity reduced dramatically. Same fate affected the three metallurgical complexes owned by ARCELOR-MITTAL in Romania at Galatzi (South East on the Danube), Hunedoara (Centre-West) and Jassy (North East). This of course meant a relief during the gas crisis in January as reduced activity meant that Romania was able to traverse the month of January without difficulty while using at maximum its own hydrocarbon reserves but it also meant a further plunge into red of the state and state social insurance budget which ended the year with a deficit equivalent to almost 6% of the GDP. This sorrow state of facts was made even worse by the fact that the liberal Government recklessly pursued even throughout 2008 the same policy of reducing contribution rates for mandatory social protection funds (notably pensions) a fact which further limits the room for manoeuvre of an eventual stimulus package (i.e.: from the current level and given the parlous state of the public pension fund finances contribution rates can only be increased a fact which is wholly inappropriate in times of crisis).

Unemployment rate rose sharply, as actually predicted one year ago by the SYSDEM correspondent, reaching at the end of the year (Dec.08) 4.4% by the national definition, after a constant and unabated growing trend during the whole of autumn months, thus marking a full 25% increase as against values in mid-summer 2008, and a full come back towards values recorded two year ago. What is worse of course is the fact that the rising trend is more than likely to continue, with the forecast made in the last report by the SYSDEM correspondent of a national definition rate at or even above 6% even earlier that mid-2009, more than likely of getting confirmed. Harmonized rate data are not yet available but one can only presume that given the ever increasing rate of lay-offs, it might have easily have gone close to the 6% threshold for the last quarter of 2008, with a growing short and mid-term perspective.

Update on key economic and labour market indicators

By all measures of volatility the last quarter of 2008 has been one of the most volatile in the recent economic history of the country. Since the commencement of our tracking mechanism for the main variables of the Romanian economy and labour market (q1.2003 or 24 quarters ago) there has never been such a degree of volatility of the four variables (exchange rates of the RON against the EUR and the USD, GDP% and the CPI inflation rate) for which we are calculating this abstract statistical measure.

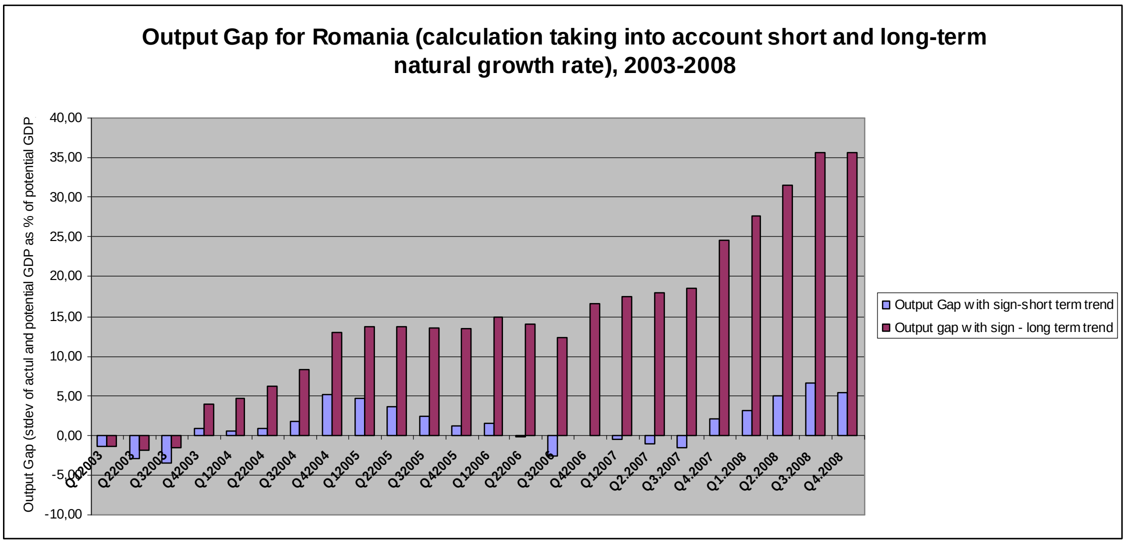
Chart No.1



Source: Calculations of Dr.C.Ghinararu basing on NIS data ;

Moreover and that is the most significant aspect of all, while previous bouts of volatility recorded throughout our period of observation have been related to what we may as well call “domestically determined variables” (GDP% and CPI%) the recent bout of volatility though to an unprecedented extent affecting growth is more than clearly associated with the “outside-world determined variables” or in other words with the exchange rates against the two major international reserve currencies. This first points to the almost-entirely externally-induced woes of the Romanian economy and secondly to the fact that starting with 2006 ad 2007 as we will point in the paragraphs to come, the Romanian economy has integrated sufficiently enough with the world economy to be now sensitive to its gyrations to an extent hard to imagine until recently. This also re-enforces the fact that its recently acquired openness, while beneficial in times of plenty, is now acting against its fortunes.

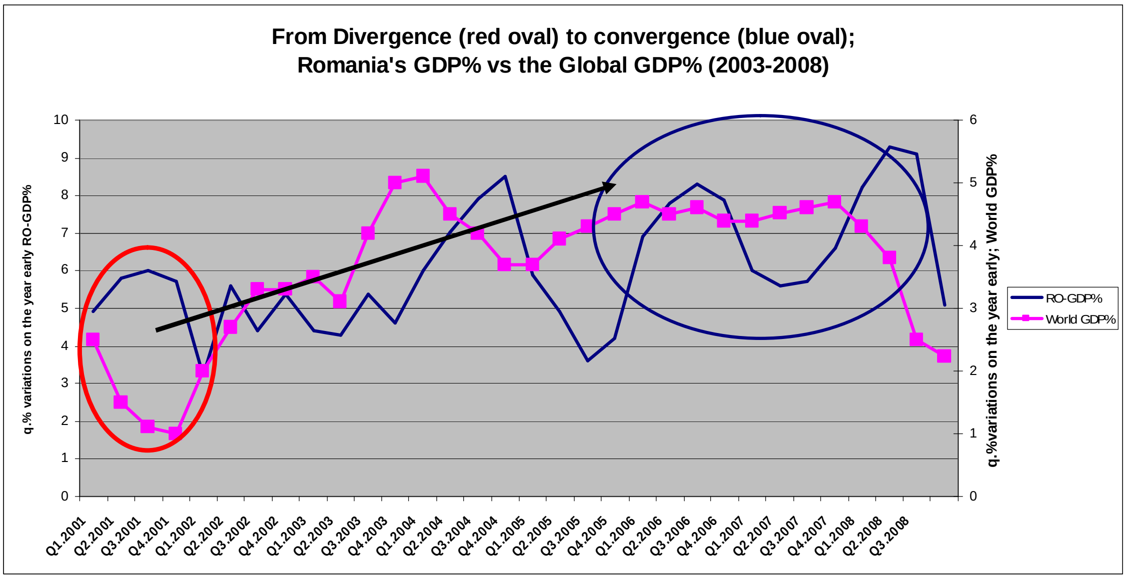
Chart No.2



Source: Calculations of Dr.C.Ghinararu basing on NIS data;

GDP evolutions were marked by the same volatility which unfortunately does not bode well. The trend-line of GDP% for our period of observations clearly draws a constantly upward move, which therefore signifies also that the natural rate of growth for the Romanian economy, an economy long deprived of growth has been constantly on the rise, with the latest values as displayed by the trend-line positioning themselves above 6%. From such a perspective values of the growth rate of 8 or even 9% as attained by the Romanian economy in mid-year 2008, were of course far into positive Output Gap Territory only if we consider a long-term trend that would stretch us to the beginnings of the Plan to Market Transition period. However, if we do take into account just the more recent period, which is the one when the Romanian economy really got inter-connected with the world one, meaning that it has also acquired the basic features of an emerging market economy that can play on the world market, albeit marginally, then we might see that they were most probably only marginally into positive Output Gap territory therefore marking a only normal recuperation after a long period of actually lack of growth. From his point of view the mere fact that growth rate sank in the year to the fourth quarter to an estimate that might go between an optimistic 5% and a morale-sinking 2.5-2.8% with both values putting it FIRMLY into negative Output Gap territory, is worrying. Even more worrying is the fact that although throughout the period of observation there have been other episodes when growth rates marked a sudden plunge, those plunges were domestically-determined and had little to do with the international context. Now, for the first time ever in twenty years of economic history and for the first time in our 24 quarters observation period, the slump is synchronized.

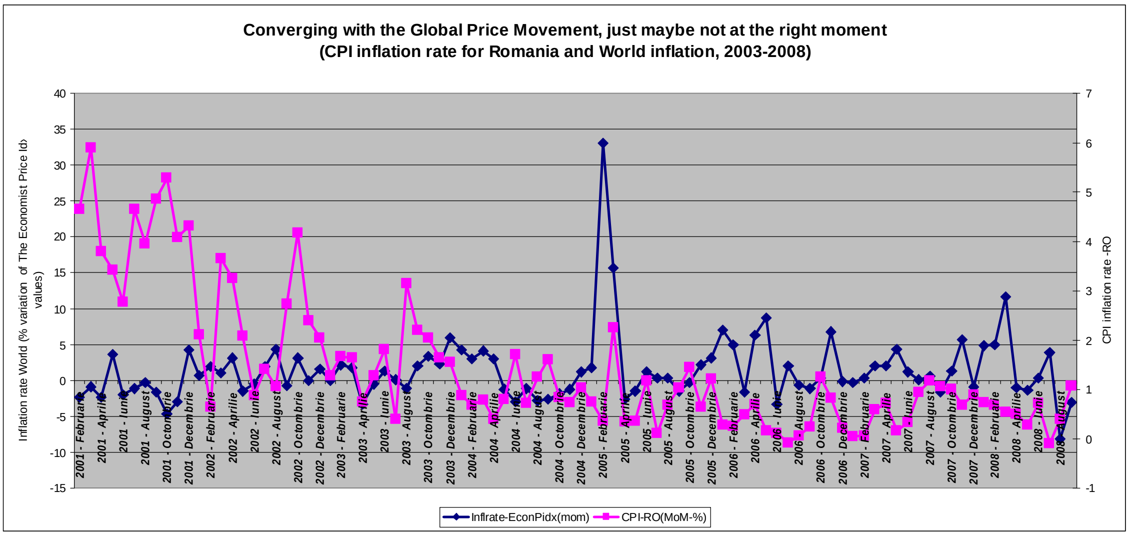
Chart No.3



Source: NIS and *EIU* data plus calculations of Dr.C.Ghinararu;

Inflation rate which also has marked a deeper synchronization with world patterns during the later quarters of our observation period, has marked a quite significant fall from the all-time height in mid-summer, when oil prices, with the move of which a clear correlation has been spotted already, reached an quasi-all times high. Since them as the price of crude started to back down and with it prices for all major commodities, inflation rate also entered a falling trend. From values of almost 9% in the year to July it slumped to around 6% in the year to December. It would have gone probably much lower if it wouldn't have been for the depreciation of the RON, both against the EURO as well as against the US$, which has kept the lid over prices increases still open and this in spite of the rapidly falling domestic demand, markedly visible in sectors like cars and white goods which have been star performers of sales in the last two-three years. Again like in the case of growth, while previous moves of the inflation rate did no show much of a correlation between world markets and Romania, starting with 2004-05, therefore with the middle of our observation period the synchronization has been getting ever closer and it got now visible.

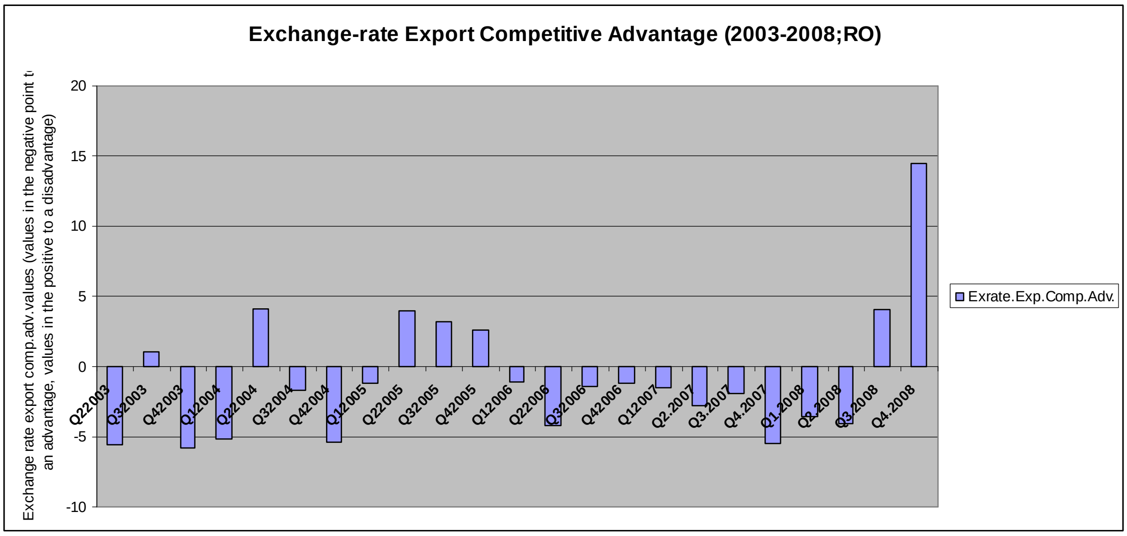
Chart No.4



Source: NIS and *EIU* data plus calculations of Dr.C.Ghinararu ;

As said before, the exchange rate, as the main channel through which the world economy makes its now freezing blow felt on the domestic market, has seen important gyrations throughout the last quarter of the year. The RON depreciated itself erratically both against the EURO as well as against the USD feeding thus into inflation and partly offsetting the effect on prices of lower demand and lower prices for both fuels and other commodities. The flight of capital as investors were divesting themselves of Romanian and Romanian-currency especially denominated assets made the national currency depreciate up to the threshold of almost 4RON/EUR, thus marking a loss of its value of around 6% if we take quarterly averages as against the third quarter of the year but climbing to more than 10% if we take into account the lowest value in the middle of the third quarter and the highest of them at the end of the last quarter of the year. Even more precipitous was the loss in value as against the greenback, where on quarterly averages which mask quit well the more abrupt gyrations, the depreciation was of more than 20% quarter on quarter. The central bank tried hard to stem the fall by keeping its benchmark interest rate at a quite high more than 10.5%w, a move that was quite in contradiction with the sharp cuts recorded elsewhere in the world. Thus it made the credit-crunch look even tougher for Romanian households and firms, which had to cope with the twin pressure of high interest rates and a depreciating currency. This as said only highlights the fact that emergent economies have little room for a stimulus of the kind available to developed economies. Operating with local currencies they are exposed to intense volatility of the exchange rates and to sudden depreciations, a fact that can maintain inflationary pressures even when demand is falling. An unstable currency renders the cost of borrowing prohibitive while increasing in the meantime the price of inputs, a fact which nearly nullifies the exchange rate-export advantage that comes with a relatively depreciated currency. From this perspective the evolutions of this constructed variable for the Romanian economy are illustrative. While during the first two quarters of the year the relatively mildly depreciating RON against the EUR, coupled with a RON that was keeping relatively strong as against the US$, were helping create an exchange rate competitive advantage for the Romanian exports, the sudden and abrupt depreciation as against the EUR did no longer help as it was coupled with an abrupt loss o value against the US$, which as a result made all inputs dearer. This exemplifies yet another danger facing small open economies, especially the ones in Central and Eastern Europe, where a slump on the developed market affects them on several fronts, with shrinking demand on their main export market being compounded by a loss of competitiveness as inputs are getting more expensive due to depreciating currencies. Accordingly, the fourth quarter of 2008 was, from the point of view of exchange-rate related export competitive advantage, the most disastrous for the Romanian economy since we have commenced our observations 24 quarters ago!

Chart No.5

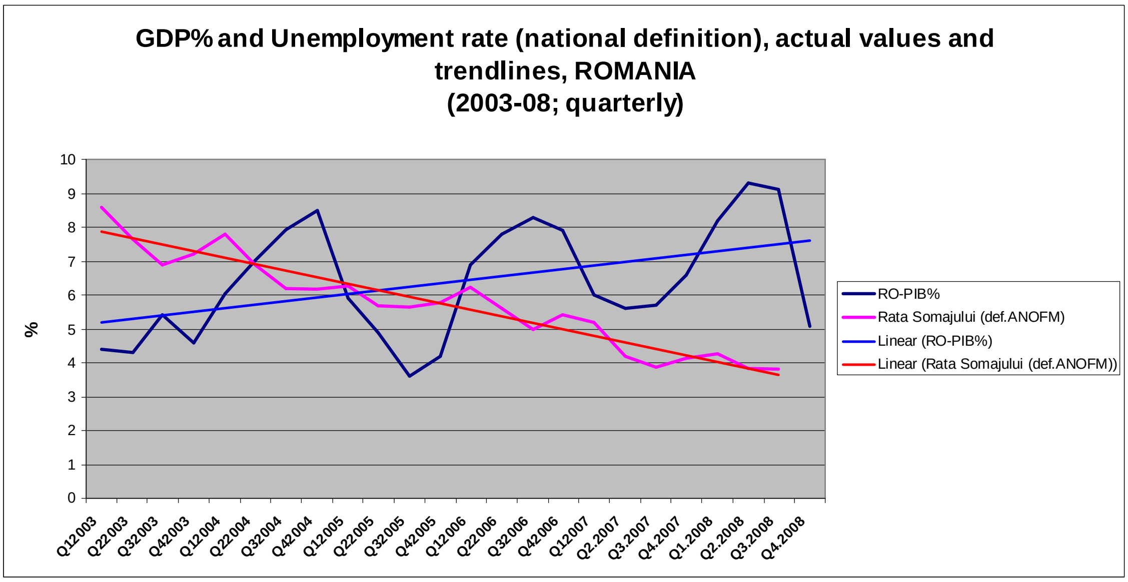


Source: NBR data plus calculations of Dr.C.Ghinararu; Attn: *Negative* values show the existence of an exchange-rate competitive *advantage*; *Positive* values show a *disadvantage*;

Labour market aggregates as far as they are available for now, show clearly enough that much o what has been gained recently stands to be lost in the current economic turmoil if action is not taken and taken fast. As such although employment has not been particularly benefiting from growth at least at its most aggregate level, with Romania still lagging rather far behind the Lisbon targets, the trend for the last 24 quarters was nonetheless displaying a simmer of growth. But this has not been the main and most significant o this period of growth hat started at the beginning of the current decade. Instead what was remarkable was the shift in the structure of employment, away from subsistence agriculture, the main employer at the onset of the decade and towards services. But even more than that, the really important thing that happened during the second half of our observation period was the stabilization of industrial employment in itself a sign that the economy was slowly but surely ceasing to be just a Transition economy gradually turning itself fully-fledged emergent market one. Unfortunately enough, the time passed since the moment when the share of industry in total employment stabilized and the current moment when the global crisis is hitting hard is pretty short. This in itself is another proof that the structure of the Romanian economy is feeble, its internal market underdeveloped and irrespective of the cheers that the increase of the share of services in total employment attracted throughout the time, in itself it was less important as it just highlighted the contagion of the global "*irrational exuberance*" (see Greenspan), an element that was of fundamental if not of critical importance in the other contagion, the one with *the world economic malaise*. It is expected therefore that during the next period, which might as well mean the next three or four quarters, signalling thus a deep recession, the causes of which we will more in detail examine in the paragraph dedicated to wages and productivity, all aggregates will depart themselves even more from the Lisbon targets. Employment and participation rates will fall and unemployment will be on the rise. In the meantime, it might be as well that the traditional refuge subsistence agriculture employment will start again getting on a mild rise.

However and as the SYSDEM correspondent correctly forecasted more than one year ago when the first manifestations of the current downturn surged into what was the housing market crash of mid-summer 2007, the aggregate that will see the most dramatic changes and for the worst will be the one that has illustrated probably the best the benefits of the recently and much too abruptly cut period of economic growth, namely the unemployment rate. While throughout most of the last 24 quarters in a row we have been able to trace a clearly declining trend of the dole, more poignant when looking at the national definition one but also becoming as growth was getting entrenched so to say visible also in the moves of the harmonized measure, it is more than clear from the evolutions of the last quarter of 2008 that this trend is going to be reversed at last for the following few quarters in a row. Therefore a return to the unemployment rats that were characterizing the commencement of the decade is not entirely impossible. It has to b noted that only the last few months of the year, when lay offs were not so important with the most of the enterprises actually announcing temporary closures or reductions in the number of hours. The total number of unemployed registered a quite sharp rise from 345510 in mid year when the economy was still booming, to around 403441, with the last months showing increases in the tens of thousands while previously the variations could have been counted just in thousands. It is to be noted that most of the employers were not yet sure what to do in the last quarter of the year as only in November and mostly in December the economy started to get visible signs of choking itself. As such, while the month of December brought actually mass lay-offs amounting to around 14 thousand persons as against the more staggering 22 thousands initially announced by the employers out of which however, only around 5 thousand registered with the offices of the NAE, it is more than clear that in the months to come the tide will only get higher. Already a large number of the enterprises are starting to shed massively labour and even large services based centres like Bucharest are starting to feel the pinch. The plan of the new Government to reduce the number of jobs in the public sector by around 20% as well as the already instated measure of blocking all vacancies makes perspectives dire. This is even more as most of the increase in the vacancy rate has been lately coming from the public sector mostly.

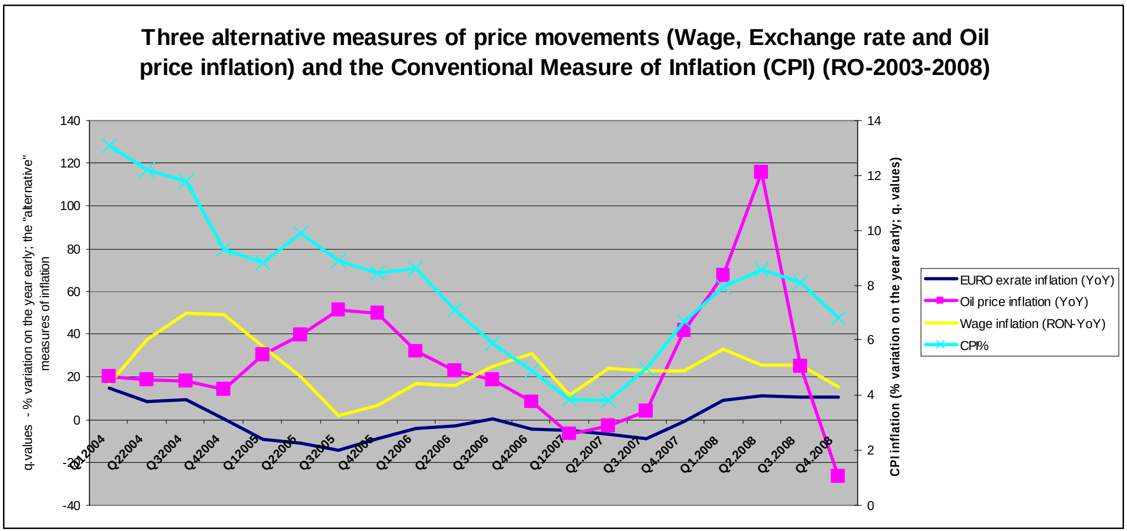
Chart No.6



Source: NIS and NAE data plus calculations of Dr.C.Ghinararu ;

Wages have continued being on the rise in the last quarter of the year, though at what we would call a markedly slowing pace. Of our three alternatively-constructed measures of inflation, namely the RON/EURO exchange rate inflation, the oil price inflation and the wage inflation, two, the oil price inflation and the wage inflation are showing a clear disinflation trend (the oil price inflation rate shows actually a deflation trend), with the wage inflation rate losing no less than 18 pp., compared to its maximum level reached in the year to the first quarter of 2008, when it a high of 33%. This clearly shows that the rise in salaries while still keeping strong during the whole of the 2008 has been clearly on the slow down. The descending growth trend only serves as to confirm that the entire drive in salaries far from being one divergent from the rise in productivity has been one that kept actually the pace with productivity. As soon as the surge in productivity started to exhaust itself as the investment drive was giving way to a natural trend towards reaping the return on investment, the rise in wages entered a slowing path. This is not as to ignore the other reality which is illustrated by the constructed measure of the growth in wages as against the Sum of Productivity and Inflation (CPI one) and which persistently for almost the whole of the observation period exceeded this conventional threshold. However, even if as such, the explanation stays again in the very low starting point of salaries when bringing the discussion into absolute numbers. However, looking at three alternative measures of inflation while not being able of rule of course out the salaries as a culprit for the stoke in inflation one cannot consider them as being the main one. While exchange rate evolutions have up until recently contributed to disinflation, what actually brought about the bout in inflation during the last half of 2007 and first half of 2008 were clearly oil prices. With these clearly on the deflationary path and with the wage inflation on a clearly decreasing trend, the only stoker remains now the exchange rate, actually the main culprit for inflation in the last quarter of 2008 and likely to remain for the quarters to come.

Chart No.7



Source: NIS data plus calculations of Dr.C.Ghinararu ;

<u>Buttonwood</u> – On the effects of the crisis and policies to pursue

Of course one can only ascribe to the conventional wisdom that salaries have to grow in line with productivity but, there are several caveats to that when it comes to the economies of emergent markets in Central and Eastern Europe, Romania being a striking case in point here. The starting point from which this surge went on and went it did on a quite dramatically fast pace was in absolute numbers a dismal one. At that level, the solvency of the domestic market was for all purposes close to nil. Of course a low level of salaries constitutes itself a magnet for a certain type of investment. But even this type of investment brings in about a hike in productivity. Slowly by slowly the solvency of the market improves (i.e.: read the salaries grow) and this in turn attracts even more investors. The higher the solvency of the market actually the higher the volume of investment attracted. Therefore and from here the need to maintain and even constantly increase the solvency of what is still a poorly solvent market with a limited purchasing power, for this sustains growth and attracts more investment the only way productivity can possibly increase and ultimately close the development gap. If hardly achieved solvency registers a sharp drop then investment will start receding, divesting might even start if the drop in solvency persists and finally all progress might be lost. In this line of thinking instead of tightening the reins of the economy and doing practically everything to curb spending, the Romanian authorities should do what all Governments do around the world, attempt everything to encourage spending, especially as the threat of commodity-driven inflation is as remote as ever. However here comes into play our third measure of inflation, the exchange rate one. In the case of the small economies, with a currency circulating on what is an only partially solvent market periods of general economic boom bring about a strengthening of the currency which makes the exchange rate act as a tool of *dis*inflation. In the meantime however, periods of general economic gloom bring about massive and erratic outflows from assets denominated in such currencies making exchange rates act as stokers of inflation. Accordingly, an inflationary type stimulus like the one that is attempted currently in developed economies would be conventionally inappropriate for these economies as it might trigger a run on the currency and finally a complete meltdown. However, stamping on consumption will mean that recession will get prolonged, more jobs will be lost and finally with the solvency of the market getting lower and lower, the currency will anyway, albeit if at a slower rate, depreciate. At the core of this conundrum of emergent markets, especially the ones in Central and Eastern Europe and which is made apparent by the co-existence of a slowing demand with far much higher than normally inflation induced by a depreciating currency is SOLVENCY. Solvent markets will manage to reverse at a certain moment depreciation of the currency and even rebalance the public budget and in time they will also bring down inflation not to mention that they will foster job creation. Insolvent markets, markets that are mopped-up of their liquidity in an attempt to achieve an anyway short-lived balance of the budget, will not be able to support their currencies which will ultimately continue to depreciate dampening demand even further. The end result will be massive job losses, a still depreciating currency, a more than ever insolvent demand that will turn the market utterly un-attractive and a budget that will anyway lose balance due to a chronic shortage of revenues. Therefore, while conventional wisdom might push us towards the deflationary solution the brave way has nevertheless to be followed, even if it poses some risks. One should actually never forget the ancient motto: *FORTUNA AUDACES JUVANT*!

Government Perspective(*s*) on the Financial Crisis

Both during the last quarter of 2008 as well during the first month of 2009 companies have started to shed staff or to opt or temporary lay offs, often known under the term of “technical unemployment”, under which a fraction of the basic salary (usually around 75%) is paid to the employees while they are awaiting a recall from their employer. The automotive industry has been hit pretty hard with the DACIA-RENAULT factory in Pitesti remaining close for almost the whole of the month of December and the first decade of January. This move has affected many other small and medium sized companies producing parts and accessories for this RENAULT-Group subsidiary. Although the factory did not yet start to shed staff it has opted not to renew determined duration contracts and is foreseeing yet another probable temporary closure in February.

Metallurgy is yet another branch feeling the pinch of the global downturn particularly hard. All the three steel mills owned by the multinational ARCELOR-MITTAL in Romania, Galazi, Hunedoara and Jassy have seen their output shrinking fast. Employees have been asked to take their statutory annual vacation in turns during the first quarter of 2009 as orders are constantly dropping. Moreover, the number of hours worked has been drastically reduced and there are reports that the management is encouraging voluntary departures by offering severance payments. Mass lay offs are more than likely if the downturn continues. Trade unions have staged recently a massive protest asking the Government to make it mandatory for companies awarded public works contracts to buy steel products from the Romanian plants. Calls for protectionist tariffs so as to block what unions are calling as dumping imports, including from countries in the EU have also been widely heard. Same tensed situation is reported at the Russian owned aluminium smelter in Slatina (county of Olt, South of Romania).

Also hardly hit has been the chemical industry. Although the reduction in gas consumption may have been welcomed by the Government during the gas crisis of early January, the closure of the activities at the AZOMURES chemical factory in Targu Mures (county of Mures, Centre of Romania) was for surely not the most welcomed of news for both the employees as well as for the local and county council for which the company was a major source of income. An even greater impact at local level will have the almost total closure of the SOMETRA chemical plant in Copsa Mica (county of Sibiu, Centre of Romania). The small and almost wholly mono-industrial town might not even be able to pay in the months to come for waste disposal and public lighting as the company was the main contributor to its smallish budget.

Apart from major companies a host of other small companies have been hit hard. The construction sector is also strongly buffeted by the crisis by the full impact will be only be visible spring when for surely far fewer cranes will start moving on the skies of Romania’s cities.

Other sector hit are textile and leather industry, retailers, financial services especially credit brokerage firms which are closing one by one as banks have practically blocked almost all lending and most recently announces have been made that oil industries which are now starting to feel the impact of months of declining oil prices, will start shedding staff.

It was also originally announced that the number of employees in the public administration will see a full 20% reduction which, in absolute numbers would have meant a job loss amounting at national level to 1,500 - 2,000 jobs. It is still unclear if the Government wants to pursue this line to the end, especially as it has been working hard with the unions and employers association so as to lure them into a sort of Social Pact that would allow the smooth implementation of a deep-austerity budget, practically nullifying all of the promises made during the election campaign by the two parties forming now the governing coalition.

Therefore there are worries that national definition unemployment rate might be already at 6%, which would mark a 36% increase as against the month of December, but official figures were yet to be released when this report was written (Feb. 7.2009).

No stimulus package of the sort being implemented in the developed economies is envisaged as yet by the Government. Therefore is unclear which of the industries that already bore the brunt of the first shock of the crisis will receive some state help. However, in a meeting with the executives of the US automotive giant FORD which pans to develop a production capacity at Craiova (South West of RO) president Traian Basescu pledged a unspecified support for both of Romania two major car producers, the DACIA-RENAULT and the FORD. How this will materialize is yet to be seen as the prohibitive tax slapped by the former Government in his last days in office and which was hiking the amount paid for the registration of old cars has been considered by the EU Commission as in breach of EU legislation.

In the meantime the Government is aiming at trimming the budget deficit by implementing a wide scheme of public expenditures reduction. However, the first attempts were rather rash and unsuccessful. Via Emergency Ordinance it has tried to limit the right of old age pensioners to work in the public administration and in any service that receives public financing, including by this health, research and most notably education. This would have brought great savings according to Government estimates, though it is not yet clear how much. Fact is that the Emergency Ordinance has been repealed by the Constitutional Court so it has failed to produce any effects whatsoever. As the Government has nonetheless pledged itself to cut all public expenditures by 20%, a internal Memorandum has been issues asking all public authorities to compulsory terminate the labour contracts of staff at or above statutory retirement age. Also all vacancies in public administration have been blocked.

Research funding from public sources will also see a reduction by 65%. Practically all research contracts will be put on hold and a large part of the staff (rough estimates run into a couple of thousands of researchers and auxiliary staff) will have to be probably laid off.

However the Government plans to allocate more than 20% of the budget resources for infrastructure works. Starting with 2010 profit that will be re-invested will be exempted from taxation. The impact of this measure is estimated to be worth the equivalent of 0.59% of the GDP itself estimated in the budgetary projection for 2009 to reach EUR. bn.144.7, taking into account an estimated rate of growth of 2.5% as against a more conservative estimate of the Commission of 1.8% and a truly bleak one made by the IMF which puts Romania squarely into recession with a forecasted rate of growth of -1%.

In order to re-balance the state social insurance budget and ensure the financing of the state pension scheme, contribution rate will see a rise by 3.3 pp, which will mean that the combined rate paid by the employer and the employee will reach 31.3%, with 10.5% for the employee and obviously the rest for the employer of course for normal working conditions. Contribution rates for arduous and very arduous working conditions have also been hiked. Out of the contribution rate paid by the employee the share of the mandatory private pension funds will be frozen for this year, according to the draft budget law submitted a couple of days ago by the Government to the Parliament, to2%. The planned increase to2.5% will therefore be put on hold. The private pension funds federation has threatened protests and said that losses will be huge both for the administrators which have made sizeable investments as well as for the beneficiaries. Moreover they claimed that jobs in the financial services industry will be also lost. The correspondent's opinion on the matter is by now well known: The carve-down of the contribution rate for the public pension scheme should have never been taking place. Private pensions funds, mandatory in their character or not, should have been financed exclusively via a top-up of the contribution rate. Such a solution, if adopted at its time, would have saved a lot of the current trouble. This point is actually taken integrally by the Commission's January 2009 interim forecast, the section on Romania (see page 38 of the document, paragraph no.3). Also the Commission's document reiterates the fact that much of the current deficit, especially with regard to public pensions' commitments, can be blamed on the reckless reductions in the contribution rates effected by the previous Government throughout its years in office and against which, the correspondent has warned at the time in subsequent reports.

Although the Government does not entirely rule out salary increases, they will be more than modest. The planned increase of 50% voted by the previous Parliament in its last session and which regarded salaries of personnel in education will become actually an only 5% increase, to be applied to all public employees, in two instalments. Also the Government has committed itself to the elaboration of a new law that would make re-arrange salaries for public officers and other personnel in publicly financed bodies according to the same rules thus removing all types of distortions and helping to reduce waste in public spending.

Pensions will also see only a modest rise of 5%, with the same two instalments being foreseen. This will squarely mean that the Governmental commitment of having the value of the pension point at 45% of the gross average salary gain starting with the 1st of January is by all means shelved. Therefore the value of the pension point will be actually for 2009 somewhere in between 42 and 45% of the above-mentioned threshold which, in fact, will amount to a full stagnation of pension incomes or in the best of cases to a very modest, totally marginal rise.

Although it is rather difficult to categorize the measures taken by the Government and to give all details for each of them as they have just been enacted or are actually in process of being enacted as they have to be approved as part of the state and state social insurances budget which have just been submitted to the Parliament a couple of days ago, we will nonetheless attempt to do it and organize them as such in a table-type format:

Flexicurity component	**Measure adopted or planned**	**Timing (approximately)**	**Budget allocation (where available)**	**Expect Results/Likely Effects**
Contractual arrangements	Limitation of the right of old age pensioners to work in the public administration	In application in a *lighter* form (compulsory termination of the contracts for those reaching statutory ret. age, after a first and more drastic form has been repealed by the Constitutional Court	Not available	It might trim to a certain extent the salary bill of the public administration but, in the meantime it will mean that activity rates which are already low will get even lower. An important part of the labour force will be practically pushed into idleness;
	Cap the salaries of state officials, high ranking civil servants and executives in the public administration	To start app. Beginning with Feb.2009	Impact estimated to around 0.1% of the GDP	To our opinion the impact is much exaggerated. Moreover it is difficult to see how some top management positions in important SOEs where responsibilities are vast (see the National Nuclear Electricity Company or the National Hydroelectric Company) will be filled at salaries that will not be much in excess of EUR 1000 (gross amount!);
Labour Market Policies	Increasing the length of unemployment benefit period by three months	To start following the approval of the state and state social insurances budget	The overall allocation for the Ministry of Labour which includes the budgets of the state administrated social insurances scheme (pension and unemployment chief amongst them) is projected at the equivalent of 10.97% of the GDP or in absolute numbers EUR bn.15.87, of course taking into account the macro-economic assumptions detailed in the paragraph above; **The budget for the unemployment insurance fund** (at least projected) is worth 338 mil. EUR at forecasted	It might as well help a bit but it would require an increased amount of transfers from the state budget to the budget of the unemployment scheme which ahs been plunged in the red by the same reckless reduction in contribution rates against which the undersigned spoke so often;

			exchange rate of RON 4.3/EUR; The budget is projected with a deficit of 1.5 mil. EUR to be financed by transfers from the state budget;	
	Incomes derived from "technical unemployment schemes" applied by the enterprises to be exempted from social security contributions for three months following the moment of application	Same as above	Not yet available	It might alleviate some of the pain but it will be difficult to sustain if growth projections will not materialize themselves. If the doomsday scenario of the IMF will materialize then it might be as well that this will dig a huge hole into the state social insurances budget;
Lifelong Learning Strategies	Establishing budget allocation for Education to the equivalent of 6% of the GDP but…	Same as above	The total budget allocation for education taking the Govt. GDP projection will be of around EUR bn.8.68;	It might bode well for investment in human resources with the sole condition that money will not be squandered on teacher's salaries thus adding to the inflation woes, which as said in the second chapter of the report are indeed receding but are not to be discarded!
	… in the meantime the intention of reducing public funding for R&D which is included in the allocation of the Ministry of Education by 65% as against last year's figures!!!!	Same as above	The total allocation for R&D will drop dramatically from the equiv. of around 0.8% of the GDP last year to the equiv of only 0.28% this year;	It will be difficult in these circumstances to try and "tap into new sources of growth" as the Commission recommends. Much of the staff will be probably lost through lay offs and precious investment will be laid idle; long term impact will be however the one that will really matter and will it for the worse, if decision applied as such;
Social Security Systems	Cumulated social insurance (i.e.: read public pensions mainly) contribution rate will increase by 3.3 pp, coming back	Same as above	The total budget of the public pension scheme is estimated at EUR bn.9.33, being constructed with a projected	The increase of the contribution rate is of course more than ill-timed as in times of gloom this is the last thing that households

	to 31.3% for normal working conditions		surplus of EUR mln.531;	and businesses alike expect. However as the last Government recklessly and against all sensible advice reduced continuously contribution rates and moreover established the "carve-down" as a principle for the financing of the private pension funds, in the current circumstances there was no other option to consider.
	Capping the share of private mandatory pension funds of the contribution rate to 2% for this year instead of the initially foreseen 2.5%	Same as above	Might as well be the source of the projected surplus	Same as above; It will however affect negatively the private pension funds which will take yet another battering alongside the ones coming from markets; Effects remain to be seen. Anyway this is a good signal so as to change the system and opt for a mixture between a carve-down and a top-up;
	Establishing a minimum social pension of RON 350 (EUR equiv at the budget projected ex. Rate of 81.3)	Application from the 1st of April 2009	Budgetary allocation equivalent to 0.10% of the GDP, with the source being the state budget;	This is one of the social measures announced during the campaign and which will be nonetheless kept especially as it seems that its impact on the consolidated budget is not quite so significant. This is due to the fact that we are not actually talking about a new social protection provision as it might look like at first sight but about a form of complementary income, to be financed via transfers from the state budget, and which will be added to existing state social insurance pensions below the threshold of RON 350 so to bring them up to this "social minimum";

The Government has been working closely with the social partners in an effort to get them agree to a budget that would practically see the complete evaporation of most of the social commitments mad during the electoral campaign last autumn. On the background of an increasing wave of enterprise closures and lay offs trade unions have been cornered to a certain extent though most of them claim that what they have given to the Government is just a moratorium until the 1st of April. Particularly difficult will be to placate unionist in education which are now practically empty handed after last fall they have been promised a sky-high increase of their salaries. It is therefore symptomatic that the only nationally representative confederation that did not sign into the agreement with the Government (a form of Social Pact) is the CSDR, the one that includes the largest education-based trade union federation. However it is commendable that a form of social dialogue has taken place. To that this will amount in the future and to what extent this will serve a to avoid massive social unrest as the crisis blow intensify themselves only remains to be seen.

As for the structural funds which have seen a more than anaemic start last year, the Government has vowed to speed procedures so as to have all the SOPs audited by mid-February for intermediary payments also. In a press conference after the Government has adopted the draft of the Budget Law, the PM has also committed himself and his administration to a revision of the procedures so as to shorten the way for a project proposal from submission to approval to no more than 3-5 months.

It is also worth noting that although the Government has to strive for budgetary consolidation on a grand scale (from an estimated equiv. of more than 5% of the GDP at the end of 2008 to around 2% for 2009) and in a period when financing the debt of an emerging extracts an ever higher premium, funds will be earmarked for the co-financing of Structural funds projects which are considered to be for Central and Eastern European emerging markets the rough equivalent of the fiscal and financial stimulus packages enacted in the developed economies. To this avail and in order to help finance the deficit the Government seeks a loan either from the EBRD or from the IMF. The PM declared hat all options are still open although recently (the last couple of days) it seems as the IMF option, although not the most favourable for the country, is gaining ground.

Just so as to contribute even more to the formation of an informed opinion, we are hereby providing in the end a synthetic table, comparing the anti-crisis measures that were envisaged by the previous Government and the ones that are planned through the State and State social insurance budget by the current administration, also organized along the four main FLEXICURITY components:

FLEXICURITY COMPONENT	Measures envisaged by the former Government (P.M. – C.P. Tariceanu)	Measures planned by the current Government (P.M. – E.Boc.)
Contractual arrangements		- limiting the possibility of old age pensioners to work in public administration;; - establishing a cap on salaries of state officials and other high ranking public officers and executives;
Labour Market Policies	- 5% tax bonus for firms and individuals alike; - 1000 EUR bonus for each new job created by enterprises on condition of hiring individuals being unemployed for more than 3 months;	- increasing the duration of the unemployment benefit period by 3 months; - exempting from social insurance contribution payment, for a period of three months, all income derived from "technical unemployment" payments made by enterprises;
Lifelong Learning Strategies	- planning the same allocation for Education as equiv. % of GDP, bur also a EUR.bn.3 as support for R&D intensive, job generating investment;	- establishing the budget allocation for education at the equivalent of 6% of the GDP but in the meantime planning a cut of 65% in public funding for R&D;
Social Security Systems	Reducing contribution rate by a further 1pp; Introducing a social minimum pension (amount remained unspecified)	Increasing contribution rates by 3.3pp; Capping the share to be directed to the private pension funds to 2% for 2009; Introducing a social minimum pension of RON 350 (300 from Apr.1st; 350 from Oct.1st)