

In 2012 wage regulation changed in a number of ways. The changes affected 74 percent of workers; these changes, however, differed significantly depending on sector. Eighty percent of companies with between 5 and 50 employees implemented the expected wage increases. Of these, 93 percent compensated all their employees – in other words, all those affected by changes in the regulatory environment. The IEER's latest analysis examines how the increased burden due to the changes in the regulatory environment affected the employment situation of small businesses. According to the analysis, jobs would have been lost and the employment rate would have declined if the expected wage increases were compulsory and not linked to salary compensation. Due to the nature of the expected wage increase (non-compulsory) and the institution of wage compensation, however, this did not happen; at the same time, although the expected wage increases, which were partially neutralized by the institution of wage compensation, did not lead to job losses, it did make it more difficult to create new jobs.

Changes in the regulatory environment concerning wages in 2012

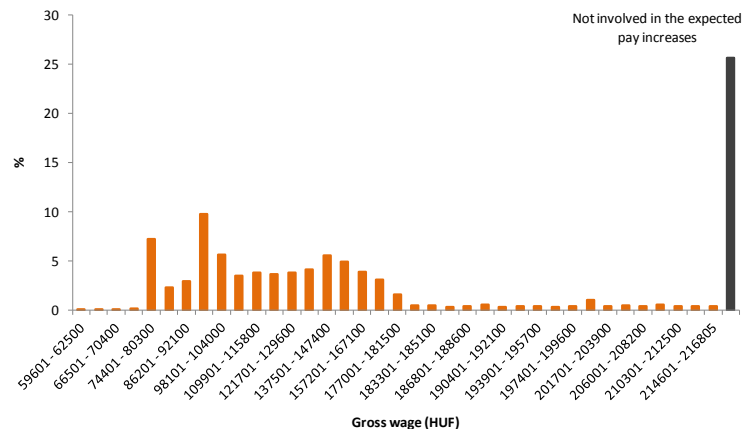
In 2012 the regulatory environment concerning wages changed in several ways: there was a significant and mandatory increase in the minimum wage (1) and the guaranteed minimum wage (2). With the abolishment of the tax credit, the net income of those whose gross salary was less than HUF 216,805 would have decreased, therefore in order to maintain wages at current levels the government introduced regulation for a recommended expected wage rate (3). Implementation of the expected wage increase would have significantly increased a company's labor costs, thus in order to mitigate this various wage compensation options (4) was introduced by the government.

Effects of changes in the regulatory environment

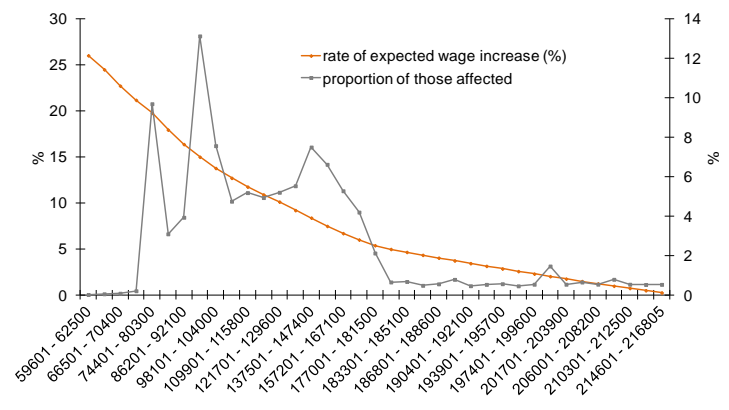
The compulsory and expected wage increases in 2012 affected different groups of workers in different ways. According to data collected on private wages and salaries in 2011 (Wage Level Recording) 74 percent of workers were affected by changes in the regulatory environment governing wages. These effects significantly differed according to economic sector:

- Those most affected were in the services (92%), tourism (92%) and agriculture (89%) sectors. By contrast those least affected by changes in the regulatory environment governing wages were those in the financial services (34%), information services (40%) and energy (43%) sectors.
- The manufacturing industry – which is the biggest sector in terms of employee numbers – was affected slightly below average; here the gross salary of 73 per cent of employees was required or recommended to be raised.
- The highest proportion of employees affected by the increase in the minimal wage can be found in the agriculture (8%) and tourism (7%) sectors. The smallest proportion was found in the financial (0.3%) and energy (0.3%) sectors.
- The highest proportion of workers affected by the increase in the guaranteed wage minimum are those in the tourism

Expected rate of wage increase in proportion to number of workers



Expected rate of wage increase in proportion to number of workers



(10%) and construction (8%) sectors while those with the lowest rate were the energy (0.3%) and waste management (0.3%) sectors.

Generally speaking, the obligatory and expected wage increases without wage compensation support – in theory – would have created an additional expenditure of HUF 14.1 billion in total for the private sector. Changes in the regulatory environment governing wages would have meant an increase of 8,800 HUF gross per employee in general and a wage increase of 11,800 gross for those workers directly affected by the changes.

Implementation of the expected wage increase

According to research from The Short-term Labor Market Prognosis for 2012, 80 percent of affected firms employing between 5 and 50 workers implemented the expected wage increases. Of these, 93 percent compensated the full range of those entitled to a wage increase, that is, all employees affected by the changes in the regulatory environment.

Only 23 percent of companies submitted an application to help maintain the net value of wages in 2012. On the other hand, 61 percent of companies took advantage of wage compensation tax benefits from the social contribution tax.

The effect of the expected wage increase on employment

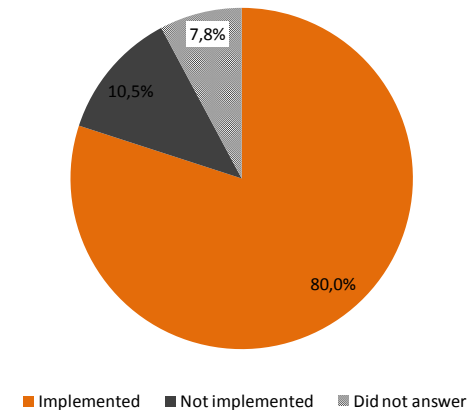
We examined through statistical estimates to what extent did the introduction of expected wage increases influence the employment policies of substantially affected small businesses in the first three quarters of 2012.

We looked at two scenarios on the impact on employment of those affected. The first we labelled theoretical, in where we assumed that all companies fully implemented the expected wage increases and did not use the institution of wage compensation. What can be subsequently examined, therefore, is what would have been the impact of the expected wage hike on the employment policies of companies without the introduction of wage compensation.

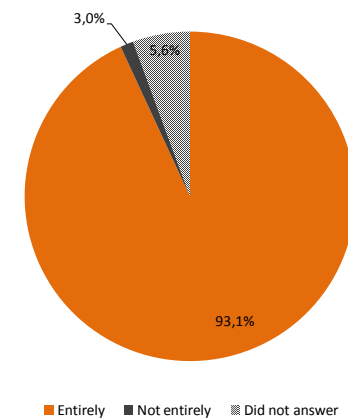
According to the statistical estimates of the “theoretical scenario”, because of higher payroll costs levied on small companies due to the expected wage increase, the chance of a decrease in employee numbers at the small firms studied is greater. The reverse is not the case, however, since the theoretical increase in corporate taxes and contributions do not reduce the chance of employment growth – in our estimates employment growth is independent of the increased rate in the corporate payroll burden. In summary, if the expected wage increases had not been linked to wage compensation then jobs at small companies would have disappeared, and there would have been a decline in overall employment.

The second version was named the “likely scenario”. Here we

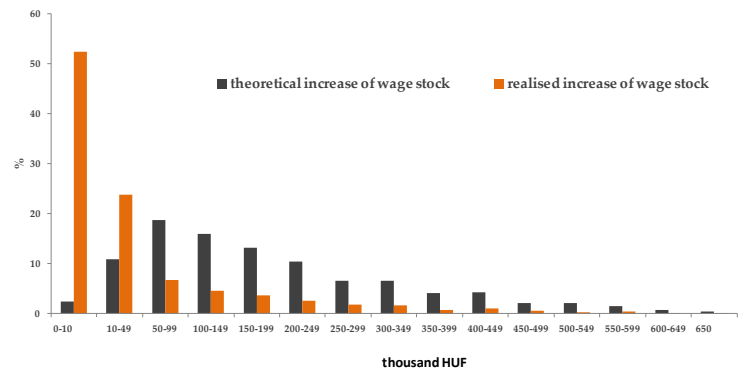
Implementation of expected wage increases



Totality of expected wage increases



Corporate payroll increase distribution due to the expected wage increase for the theoretical and the likely scenarios



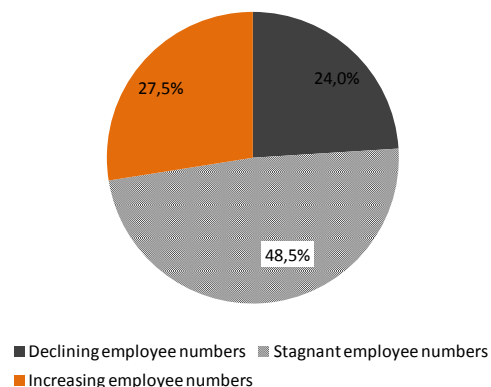
estimated the expected implementation of all wage and salary compensation forms based on survey results. The likely scenario thus simulates the implementation, which can lead to the “real” effect of expected wage increases on employment to become visible here.

While for the theoretical scenario the increase in labor costs was less than 10 thousand forints for 2.5 percent of the companies surveyed, the corresponding figure for the likely scenario was 52 percent. According to the likely scenario the wage burden for companies with between 5 and 50 employees increased by 50 thousand forints and increases above 180 thousand forints affected only 10 percent of companies.

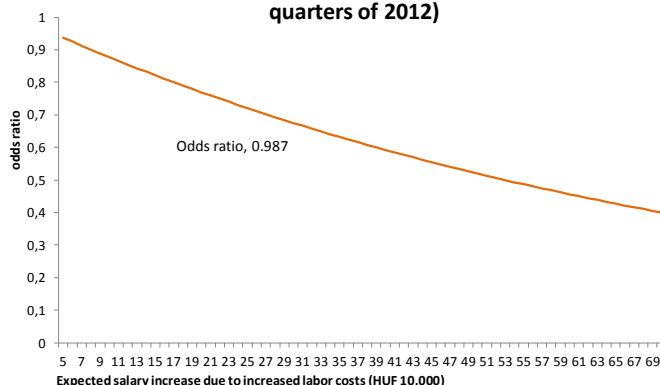
According to statistical estimates, the greater the corporate payroll burden because of the expected wage increase, the smaller the chance of increasing employee numbers at the small firms studied. However, it should be stressed that wage compensation adjusted wage growth does not lead to a reduction in the corporate workforce.

In summary, if the expected wage increase had not been linked to salary compensation, then jobs at small firms would have disappeared, leading to an overall decline in employment. Because of the type of expected wage increase (optional) and the institution of wage compensation, however, this was not the case; the expected wage increases, which were partially neutralized by the institution of wage compensation, did not lead to job losses, however it made the creation of new jobs more difficult.

Distribution of firms by the direction of changes in employment numbers



Likely scenario: estimation of changes in employment numbers - effect of higher wages (in the first three quarters of 2012)



The Ifo forecasts for the period 2013-2014

Below you will find the German Ifo economic institute's forecasts for 2013-2014. Researchers at the institute citing the Ifo business climate index see that after a poor winter performance the German economy will come to life during 2013. According to the experts, this requires that the euro-zone avoid creating a new wave of the crisis. Researchers expect German GDP growth of 0.6% in 2013 and 1.9% growth in 2014.

World Economic Situation

The Ifo institute predicts that since last autumn the performance of the global economy has stabilized. Industrial output and trade in this period did not lose any momentum, following the last two years of continually slowing growth. The main reason for this stabilization is the solid growth of the U.S. and Japanese economies. Global economic growth may accelerate slightly during the summer, as the Ifo World Economic Survey and other early and business-climate indices indicate, opines the Ifo Institute.

Assumptions

These predictions are made in the light of the assumption that the euro zone continues structural adjustments and that shocks don't occur in financial markets, which would cause a new wave of the euro crisis. In this way investor, consumer and producer confidence can be continued to be strengthened. However, this scenario is threatened by significant risks, particularly in light of extreme monetary policy. The European Central Bank's policy helped to avoid a deepening of the crisis, but it could encourage European governments to forego consolidating the economy, the Ifo institute's researchers believe.

World Economic Outlook

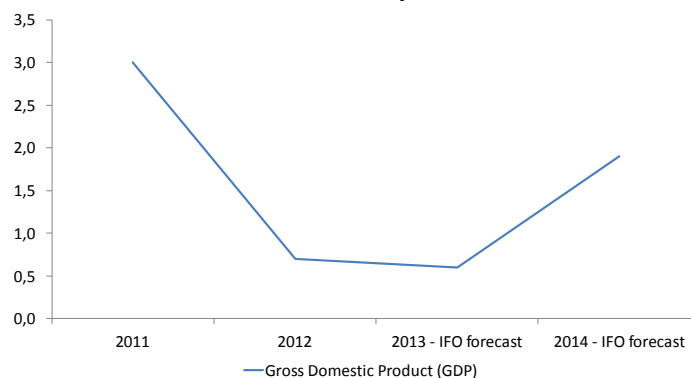
There are several early warning indicators to the mild recovery in the world economy over the summer. The need for restructuring and debt reduction in the euro-zone countries hit by the economic crisis hinders the recovery of developed countries. Overall, we can count on GDP growth of 2.9% for the world economy in 2013 and 3.7% growth in 2014. Ifo experts expect 2.6% growth in world trade for 2013 and 5.5% growth for 2014.

Prospects for the euro-zone

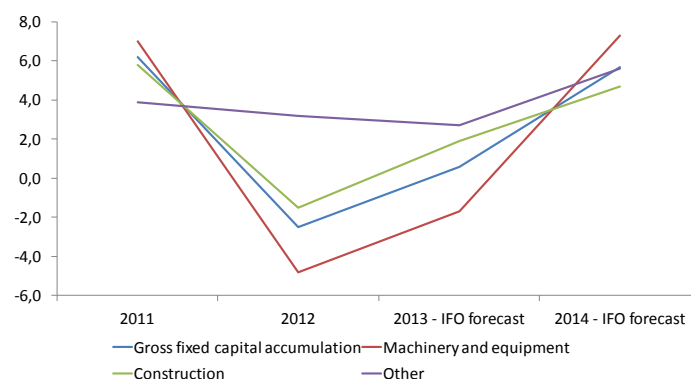
Following a winter of economic downturn performance in the euro zone may begin to recover in the second quarter. However, for the construction industry this depends largely on the weather. Overall, we expect only minimal positive growth for the rest of the year and together with the poor performance experienced at the beginning of the year this will result in a 0.6% annual decline. For 2014 the Ifo expects a 0.7% increase.

There can be large differences between Member States, however. The crisis-hit countries may continue to decline in

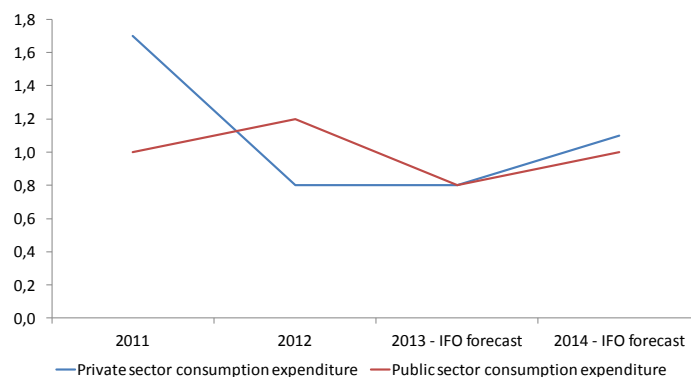
Ifo forecast: Gross Domestic Product (GDP) in Germany



Ifo forecast: gross fixed capital formation growth in Germany (%)



Ifo forecast: growth in consumer spending in Germany (%)



economic output, but the pace may be slower. The better-off economies like Germany and Austria can easily benefit from the improving global economic situation and the ease of financing options.

The poor economic situation may increase unemployment and large regional differences can be experienced in this area. Ifo analysts expect unemployment for this year at 12.4%, and 12.8% for the next. As a result of this, wage growth is low; this year it will be at 1.6% and for next year it will be around 1.5%.

The German economic situation

The German economy at the beginning of the year showed a weak performance, achieving only a 0.1% increase after a previous drop of 0.7%. In the last quarter of 2012 the unpredictability of economic development strongly dampened investment and consumer demand, and exports almost stopped. The source of stabilization in the first quarter was primarily an improvement in consumer demand while exports stagnated, according to the calculations by the Ifo.

Nevertheless, employment improved slightly, although this does not mean an increase in the number of hours worked. The decline in productivity and wage growth led to an increase in labor unit costs. The number of unemployed has increased due to expansion in the supply side of the labor market.

German economic outlook

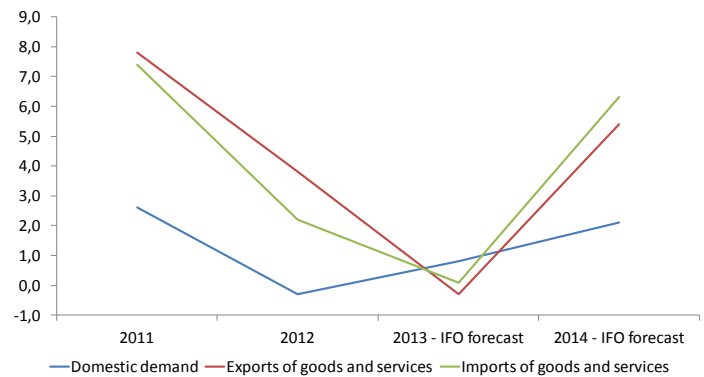
The German economic recovery clearly started in the spring months. The main source of growth was in the manufacturing industry, which was given impetus by an increase in export demand from China, Southeast Asia and from the USA as well. This was offset by bad weather associated with winter production disturbances in the construction industry. The floods caused new production disturbances in some places, but this only affected a few regions and not major companies.

Compared to developments in the second quarter, which was accelerated by catching-up effects, a slowdown in economic growth can be expected for the rest of the year. However, this is offset by losses related to the replacement effect due to the floods. In addition, major repair or replacement costs can reduce spending in other areas. The forecast takes into account the assumption that the replacement of losses will increase demand for production assets by a total of € 6 billion until the end of 2014, 3 billion of which has been already reflected in this year.

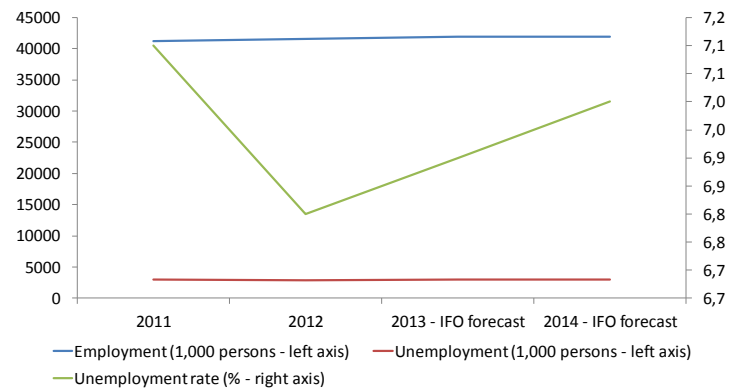
On the whole, the German GDP can increase by only 0.6% in 2013 due to poor initial performance. The upward trend in economic growth will continue next year. Due to mild and

loose monetary policy and the supply of capital at low interest rates preferential loan terms can be expected. The upturn is mainly based on domestic demand. A strong growth in construction investment is expected, consumer spending will grow at the rate of real wages – a rise of by about 1%. Overall,

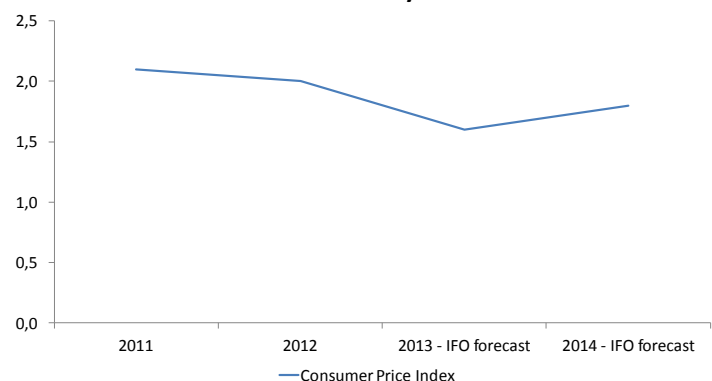
Ifo forecast: domestic and external demand growth in Germany (%)



Ifo forecast: Employment and unemployment in Germany



Ifo forecast: Consumer Price Index (CPI) in Germany

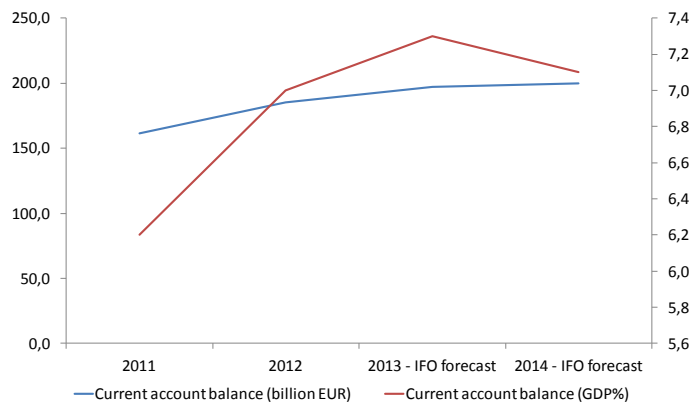


the Ifo economic research institute indicates a 1.9% economic growth forecast for 2014.

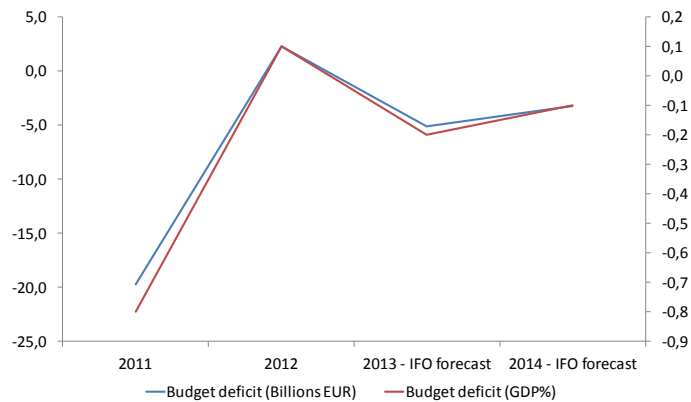
Despite the economic climate in Germany as outlined, employment may expand in 2013 by about 250,000. In 2014, this increase will be more moderate, possibly 100,000. Although the economic recovery seems to provide a greater increase in the number of those employed, the rise in labor costs of the recent years prevent this. Unemployment will also rise due to an increase in the labor supply resulting from immigration.

The German consumer price index possibly will be 1.6% in 2013 and 1.8% in 2014, thanks to the growing momentum of the economy. The government budget may end with a mild deficit of EUR 5 billion for 2013 and a EUR 3 billion deficit for 2014. This makes it possible for a reduction of public debt from 81.9% of the GDP in 2012 to 77.5% by the end of 2014 – if other debt-creating measures will not be needed, such as helping out banks and Greece, for example.

IFO forecast: Current account balance in Germany



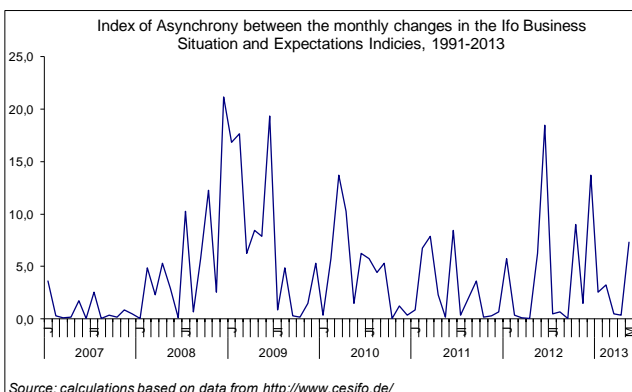
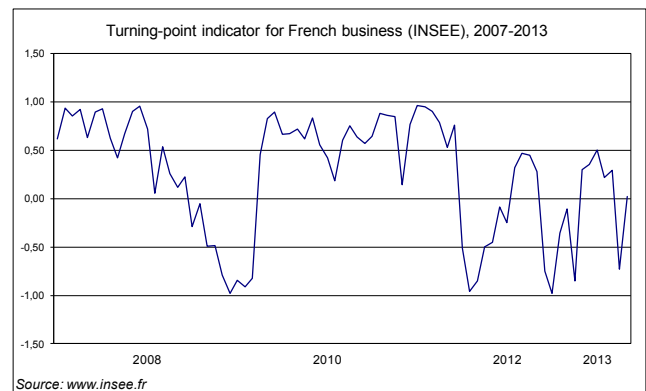
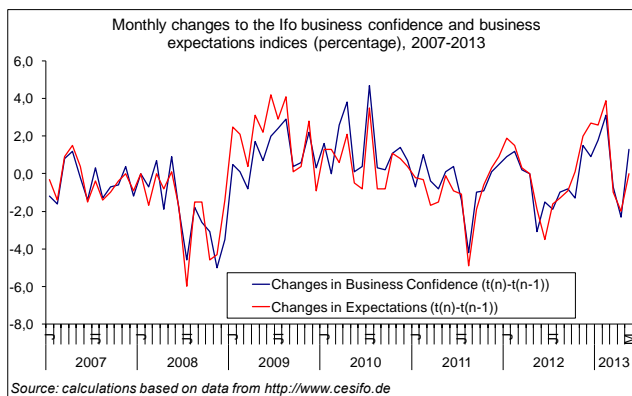
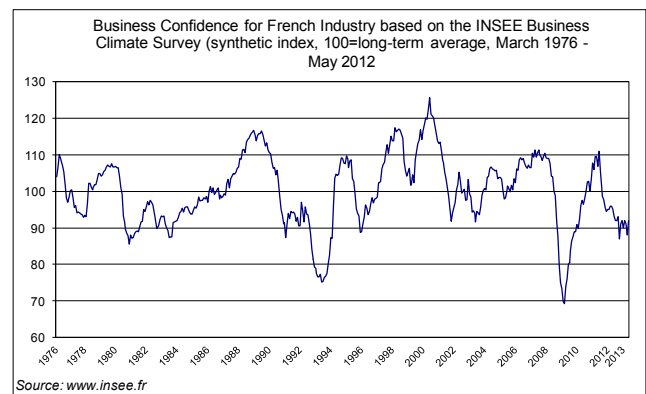
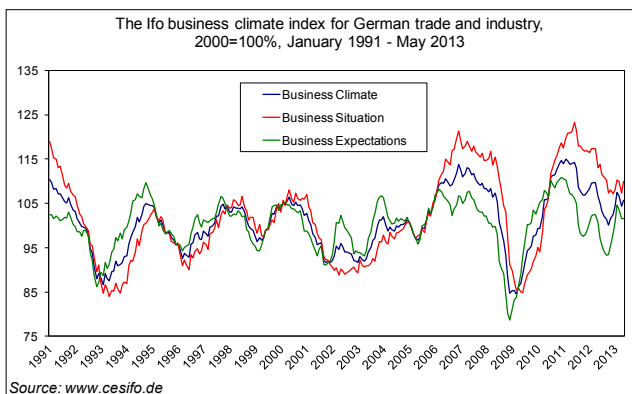
IFO forecast: budget deficit in Germany



International trends

The Ifo Business Climate Index for German industry and trade in May 2013 showed an increase after two months of decline. The companies surveyed were much more satisfied with the current business situation than in the previous month. Expectations for the next six months have not changed, they remained slightly positive. The gap between the current business situation and expected developments, as calculated by the IEER asynchrony index, rose strongly in May, so the business confidence index shows greater uncertainty than in the previous month. Ifo analysts see the German economy growing despite the unfavorable economic environment in Europe. (Source: Ifo, <http://www.cesifo-group.de>)

The French statistical office's (INSEE) survey of business leaders interviewed in May finds that French business climate improved. The INSEE business confidence index rose four points from the April figure, but it is still below its long term average. The turning point indicator remains in the uncertain business climate zone. The balance indicator of the individual business forecast of company managers shows a significant increase, but it is still very low. The overall outlook index – which represents a summary of respondent opinions on French industrial activity as a whole – was unchanged in May from the previous month's value, but the balance indicator remains at very low levels. (Source: INSEE, <http://www.insee.fr>)



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