



# **European Employment Observatory**

## **EEO Review: Self-employment, 2010**

### **Romania**

Dr. Catalin Ghinararu

National Labour Research Institute

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## **1. Introduction**

In the 1990s, at the beginning of the transition to a market economy, Romanians showed themselves to be keen entrepreneurs and although some of the entrepreneurial drive associated with those years has died out, self-employment still accounts for almost 20 % of the country's total employment. The share of self-employment in total employment in Romania is 95-97% higher than the EU-27 average. However one caveat has to be made here since, at the end of the first decade of the 21<sup>st</sup> century, more than three quarters of this figure (around 79%) is accounted for by small farmers in around 4.23 million individual farms which altogether cover around 9.1 out of the 13.9 million hectares that make up the country's total and usable agricultural surface (around 53 % of Romania's total surface). This makes agriculture the single most important sector of the economy for self-employment and also the most resilient to the crisis, as most of the farms still practice subsistence, or semi-subsistence, farming, thus having only what can be termed as intermittent communication with the market (the average size of the individual farm is 3.3 hectares). The other most important sector remains a diffuse bundle of activities, small in scale and hard to define in terms of their actual field of activity which are normally classified as "other activities of the national economy". Self-employment accounts for around 27 % of the total employment among these small firms which hover on the fringes of informality (a blurred distinction between labour and capital). It is here as well as in agriculture where women make up a more significant share of the self-employed, accounting for 15.6 % in the sector labelled 'other activities' and 17.6 % when it comes to agriculture. Information and communication technology, the one and only sector where self-employment has received a more substantial support from the state (from 2001 onwards), makes up only around 0.13 % of total self-employment although in terms of total employment it accounts for slightly more (1.18%).

Over the last decade, the attitude of successive Governments towards self-employment has been relatively neutral. While on the surface there have been some positive messages, for example in the form of a Ministry for small business and co-operatives, at ground level there has been less activity. Apart from the income tax exemption for programmers (an estimated number of around 16 000 individuals country-wide) which has been in place since 2001, the most significant measure has been the favourable (i.e. lower) income tax rate applied to micro-enterprises since 2007. Set at 2 % in 2007, the rate gradually increased to 2.5 and 3 % in 2009 but has been wholly eliminated by the Government in 2010 within its crisis budgetary consolidation plan. Farmers do receive direct payments since EU accession, but as individual surfaces are small, subsidies are also limited. Moreover, this year the Government has announced that all national subsidies for agriculture will be cut, with the sole exception of the crude oil subsidy. EU-funded subsidies, however, remain.

As most small businesses depend on the domestic market, the massive 7.1 % contraction of the country's GDP last year has hit them hard. The National Council of the Small and Medium Private Enterprises (CNIPMMR), an umbrella organisation for these firms, estimated that at least 100 000 of the country's estimated 400 000 micro-enterprises succumbed last year and this not only due to economic downfall but also as a result of the Government's introduction of the so-called 'minimum turnover tax', a fiscal consolidation measure which has hit small companies hard, especially micro-enterprises.

The Government has indicated that it is discussing a draft act to encourage start-up firms but it is however hard to see how this is being implemented in practice, as currently the self-employed face more and higher taxes and little help is being offered to the country's agriculture sector which overwhelmingly relies on self-employment.

## 2. Assessment of national Labour Market policies and recovery measures

Prior to 2005, when the flat-rate income tax of 16 % was introduced, thus spurring the development of business, especially small and medium sized enterprises, there was little concrete support for self-employment. This single most important measure (Ghinararu 2008, Ghinararu, Pavelescu and Dimitriu 2010) has greatly helped to spur an unparalleled period of growth in the country's brief market-economy history following the fall of communism in 1989. Together with the favourable tax regime that has been in place for programmers since 2001 and the favourable tax rates that were introduced for micro-enterprises in 2007, these are prime instruments that have made self-employment an attractive option for many Romanians during the last four or five years. Although non-salary employment has not been particularly on the rise, figures show that the number of individuals registering as self-employed in activities other than agriculture increased from 208 000 in 2006 to around 260 000 in 2008, this increase being owed both to the two fiscal incentives mentioned above, as well as to the provisions of the country's new Labour Code, enacted in 2003. Though much criticised at the moment, the Code has nevertheless brought about a true revolution as it removed civil contracts from the field of labour law, thus also removing the mandate for persons engaging part-time in independent activities, a popular form of self-employment in Romania, to pay contributions to the state administrated social protection schemes. While generally these are small-scale activities they are nevertheless enabling a host of individuals, especially in urban areas, to earn additional income and thus contribute to a boost in domestic demand, which SMEs stand to benefit from most. In the meantime, copyright and authorship contracts have been favoured by this period of fiscal relaxation which the current Government, eager to boost its revenue base, plans to bring to an end with both civil contracts as well as authorship contracts likely to be subject to the re-imposition of social contributions, probably as soon as this year<sup>1</sup>. While these types of contracts are exempt from contributions to the country's four publicly administrated social protection schemes (pensions, unemployment, health, risks and accidents at work) incorporated, or rather full-time self-employment, with the sole exception farmers, is not. The self-employed have to pay combined employed and employee contribution rates to all of the funds, which might amount, according to working conditions, to 44 - 45 % of their declared income. Farmers also have the option of making their contribution to these schemes, though on a voluntary basis, with contribution rates also calculated at the combined employee and employer level.

Studies on the effects of active labour market policies (Ciuca & Branza-2006) have shown that the single most important measure has been the country's Unemployment Insurance Law. However, this law has done little to mobilise entrepreneurship. The measure first enacted in 1995 provides subsidised loans to SMEs *and the self-employed* at a discount rate of 50 % calculated against the National Bank of Romania key interest rate. Credits can be granted to small business as well as to co-operatives, family associations and even individual entrepreneurs from the budget of the Unemployment Insurance Fund for a period of three

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<sup>1</sup> Measure already taken as of 1 August 2010

years, with a six month period of grace if the respective beneficiaries have no more than 249 employees and if they commit to hiring, for at least 60 % of the newly created jobs, the registered unemployed. Jobs created as such have to be maintained for a minimum of three years. In spite of the number of advantages on paper, the procedure is nevertheless bureaucratic as it involves both public employment service as well as bank screenings, which take time and therefore discourages the potential target group. Evidence collected for the National Agency for Employment (NAE, the Romanian PES) in 2006 and 2007 (Ciuca, Alexandrescu, Sandulescu -2006) has revealed that intake rates for the measure are low and in most cases funds allocated for the measure remain unused. This could be due to the fact that the studies were carried out at the height of the country's economic boom, when there was a higher supply of credit from banks and when also several other measures, including a sharp and clearly pro-cycle reduction of contribution rates to all social protection schemes, including the unemployment scheme which was subject to a 75 % reduction throughout a two-year period, have allowed for an increasing mass of liquidity on the market, thus acting as a clear disincentive for ALMP intake.

It is clear that the booming years of the early and mid-decade have been beneficial for a market which throughout a generation has seen little growth. The introduction of a flat-rate income tax in 2005, the introduction of favourable rates for micro-enterprises, as well as new labour legislation that has permitted more individuals to engage in non-salaried types of activities, have spread the benefits of growth far and wide throughout society. However, some of the measures applied between 2005 and 2008 have been clearly pro-cycle in their nature (Ghinararu, Ciuca, Mocanu, Militaru, Zamfir and Velciu for the UNDP-2007; Ghinararu, Pavelescu and Dimitriu 2010). This applies to the successive and abrupt cuts of the contribution rates to social protection schemes, which have been hailed by many at the moment as great support for entrepreneurship and small business. How much of a real support they have provided was only made clear when the crisis hit. The steep turn of the cycle (see Ghinararu for the EEO 2006, 2007, 2008) has nullified all these gains. As early as January 2009 the Government was forced to reverse all contribution rate reduction measures enacted in 2008 so as to maintain a balance for the public pension scheme. The unemployment insurance fund is in debt and recently the Government has moved to cut all related benefits by 15 %. In May 2009 the Government introduced a new minimum turnover income tax which practically lifts the tax burden for small businesses to 28 - 30 % (CNIPMMR estimates-see also [www.cnipmmr.ro](http://www.cnipmmr.ro)) and from the beginning of this year the loose regime which has benefited micro-enterprises has come to an abrupt end.

While fiscal measures and various other vehicles have been of some help to non-farming entrepreneurs, agriculture has seen little benefit. The mass of liquidity that flooded the market in the period from 2005 to 2008 has pushed the national currency up against both of the major international reserve currencies, thus encouraging imports and hitting domestic agriculture hard. The very sector concentrating most of the country's self-employment has seen its contribution to GDP formation falling from around 8 % in 2005 to around 6 % in 2008, with 2007 seeing a drop to 5.7 %. Year on year GDP indices for agriculture show negative values for three of the six years between 2003 and 2009, two of these being years when the economy on the whole did more than well. In the meantime, construction and services, both of which are extremely vulnerable to the vagaries of the market, have witnessed a surge from 6.5 to 10.5 % for construction while services as a whole have become the main contributor to GDP

formation going up to a full 49-50 %. The current economic situation in Romania shows that this shift is not sustainable for a country with a huge agricultural potential (see also Ghinararu 2005, 2006, 2007 and 2010, including the EEO-Ad-hoc request).

The Romanian Government has limited options to help. The kind of shift in the structure of the country's output which occurred throughout the past four to five years has been particularly damaging. As financial flows have dried out and with an export sector counting only for barely 7 % of Romania's GDP, the plunge came unavoidably and at high speed. Locked into what is a rather patchily designed financial assistance package where the main donor is the IMF, the Romanian Government has had little if any room for fiscal stimulus with monetary stimulus practically precluded, if we do not count the latest move of the National Bank to cut the key interest rate down to 6.5 %, in May 2010. Most of the taxes have been increased, including most recently VAT which is due to rise from 19 to 24 % from July 2010. Farmers will not receive any funding from the Government this year, apart from EU money and the crude-oil subsidy. The only few measures left are the 'green house' subsidy starting from July 2010, which reimburses households and businesses alike for investing in 'green' energy solutions (e.g. solar panels) up to a threshold of RON 6 000 (EUR 1 395) and the promised support for start-up businesses which aims to encourage individuals up to the age of 35 to set up in business by offering them a host of fiscal facilities.

### **3. Quality of self-employment jobs**

Given the particular structure of self-employment in Romania, the quality of self-employed jobs remains rather low. Farming makes for a particular case as poor productivity and sheer neglect have had a negative impact on the sector. Most farmers labour for what is one of the longest working weeks in Europe while the contribution they make to the country's GVA only amounts to 6.51 %, when in terms of employment agriculture still accounts for 28.63 %. Recent CEDEFOP projections show that even by 2020 agriculture will still make up something around 19 % of total employment. If these figures prove valid then one decade from now agriculture will still make up a fifth of the country's total employment and most probably still the largest share of its self-employment. Something therefore needs to be done for this sector, which has become the focus of national effort to promote sustainable development in a small open market economy. Otherwise the sector will continue to be negatively affected by exogenously generated shocks.

As regards the remaining share of self-employment, in the construction sector there is considerable evidence of the use of undeclared work (see also here Xenogiani and Parlevliet with the contributions of Ghinararu and Stanculescu for the OECD-2008) and in this sector the quality of jobs is very poor. High levels of under-declared work persist in retail commerce as well as in vast parts of services - all sectors where self-employment makes up a significant share of total employment.

Information and communication technology is an exception but in terms of contribution to total employment it reaches only 1.18 % while in terms of its contribution to GVA it does not exceed 1.17 %. Thus its labour productivity is actually 1 % below the national average (=100, calculated as GVA per worker). Of course crisis developments have only served as to dent the share of highly speculative, wave-riding activities such as construction and real estate, where in 2008 contribution to total GVA was a clearly inflated 10-13 %. Agriculture in the

meantime has increased its share but this only due to the fact that overall GDP has seen a devastating fall throughout 2009.

Current measures are unlikely to attract individuals into self-employment. Measures recently taken to curb undeclared work, including the creation of a Government coordinated and integrated national mechanism for the prevention and tackling of the phenomenon as well as measures to counter smuggling and tax evasion, will probably help a little but as producers' associations recently observed, moves to increase existing taxes and create new ones will practically push more businesses into the underground economy in order to survive. While it is important to bear in mind that entrepreneurs complained of high taxation and contribution rates even during times of economic prosperity (2005-08), it has to be noted that the application of purely restrictive measures alone cannot help.

#### **4. Conclusions**

Romania has seen almost a decade of strong growth, which has been greatly helped by measures designed to encourage entrepreneurship, especially fiscal measures. While some of these measures have been unfortunately pro-cycle in their character they have nonetheless encouraged individuals to move away from purely dependent employment and to try self-employment as an alternative way of generating wealth, even if on a part-time basis. However this has come at the price of a shift in the structure of the country's national economy which has rendered it particularly vulnerable. Services have flourished but easy money has discouraged investment in agriculture which is the country's sole source of sustainable growth and home to actually the vast majority of its self-employed. Recent, crisis-driven measures have not been particularly helpful for self-employment which seems to be on the course of becoming their prime victim. Increases in taxation, cuts in subsidies for agriculture, the creation of new taxes and the possible introduction of a mandatory contribution for what are alternatives to non-salaried employment (practically self-employment) will stifle individual initiative to the highest extent. While farmers are likely to continue in their work, most of the urban self-employed will simply become unemployed, inactive or worse try to move into undeclared work. If the Government does not act swiftly enough so as to complement its fiscal consolidation package with a growth and jobs package, the prospects for self-employment are poor and this may continue well into the decade to come.

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## **Annex**

Examples:

### Labour market policies: start-up incentives (Over the last 5 years)

The Unemployment Insurance Act of 2002 provides for a series of measures designed to help small entrepreneurs and encourage private initiative. First among those is the credit facility that can be extended to entrepreneurs creating new jobs and committing to hiring the registered unemployed. The facility provides credits, with a favourable interest rate, set at 50 % of the key interest rate of the National Bank of Romania (25 % of the key interest rate in judets (counties) where unemployment rate is above the country average) for entrepreneurs that either create new jobs or establish new enterprises. To be eligible for the credit facility entrepreneurs have to submit a feasibility study to the local employment agency, which will be screened by the credit committee (including a representative of the agreed bank, selected at national level by the NAE). If approved, credits are extended for a period of three years, with a grace period of six months. 60 % of the newly created jobs have to be staffed with individuals recruited from the registered unemployed, the contracts of which have to be maintained for a period of three years. The measure also applies to individuals up to the age of 30, if they have the statute of student, enrolled for the first time in a form of tertiary education public or private, provided it is accredited according to legal requirements. Evidence provided by the Ministry of Labour through its administrative statistics shows however that this measure, though attractive in its design, has not been used by many. Figures for the last years show a continuous decline in the number of beneficiaries as well as of the total amount of resources allocated for it. In 2008, only 1.3 % of total Labour Market Intervention expenditures went for measures related to support for entrepreneurship. Data for 2009 show no improvement. Actually most of these were not even credits but just consultancy services for small businesses. Studies mentioned in the main body of the text point to bureaucracy as the main factor deterring potential beneficiaries.

### EERP and national recovery measures (Over the last 1.5 years)

Although room for fiscal or monetary stimulus has been minimal given the tight conditions in the credit agreement with the IMF, The World Bank and the EU, the Government has conceived in 2009 and plans to apply in 2010 a scheme designed to encourage small business start-ups. The fiscal facilities will apply to individuals up to the age of 35 years of age willing to start up in business. The draft act provides for several fiscal facilities including exemption from income tax for a period of three years following the firm's establishment. Other facilities will include quick registration procedures, a prolongation for an additional period of two years of the tax exemption if profits are re-invested in capital goods, or in the opening of new production facilities or if at least seven persons have been hired in newly created jobs for a period of minimum 12 months.

However it has to be said that recently, the minister of finance has dented hopes for a quick application of such measures as the country's fiscal position does not allow for any significant type of support to the business sector. Therefore application of such measures has been postponed indefinitely.