

A Brief Analysis on the Dynamic Effects of the Minimum Wage on the Economy in Romania

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Abstract

In view of the EU Council's requirements regarding the adequacy of legal minimum wages in order to ensure decent working and living conditions for European employees, this paper aims to analyze the evolution of the minimum wage in Romania and its motivational role in Romania. Although the Romanian government has substantially increased the minimum wage in order to help low-income workers, this increase has not exceeded the rapid growing pace of inflation, which has resulted in low living standards and purchasing power for the disadvantaged, as there are no other financial instruments to increase the income of the disadvantaged.

Key words: remuneration, payroll, personnel, salary, minimum wage

J.E.L. classification: J1, M41, M54

1. Introduction

While there are pros and cons about the usefulness of the minimum wage, the literature is replete with studies on measuring the impact of the minimum wage using econometric models.

Wages for work need to be looked at from an economic point of view, as they are the equivalent, in value terms, of the work that employees perform in an employment relationship and, at the same time, represent the operation by which payment is made for work. (Vieru and Vieru, 2004, p. 398). Alexandru Țiclea, in his work Labour Law, he stated that ”the wage system is an economic lever that can stimulate and motivate people to increase production and labor productivity. In a legal sense, labor wages could be seen as a set of laws and rules which establish the objectives, principles, forms and elements of labor wages, but also regulate the methods, means and instruments for achieving them, thus establishing the conditions for granting, and implicitly fixing, wages”. (Țiclea, 2004, p. 547).

Minimum wage setting policies have expanded and developed particularly after the Second World War in both industrialized and developing countries. Initially, minimum wages covered relatively few categories of workers and aimed to protect those considered particularly vulnerable. Minimum wages were often seen as a temporary measure, to be phased out once wage negotiations between the social partners were stable. Early forms of minimum wages sometimes targeted protection of homeworkers or women. Over time, the minimum wage has become a main instrument of wage policy, aimed at combating poverty and imposing a lower limit on pay for that category of employees most at risk of poverty and with extremely low bargaining power in the labor market, thus guaranteeing them a satisfactory level of pay (Kirițescu, 1999, p. 10).

“In Romania, the concepts of wage and salary are synonymous, they refer to the amount received by an employee: wage represents the daily remuneration of an employee, while salary represents the weekly or monthly remuneration of an employee”. (Moroșan and Fercal, 2022, p. 2)

Perhaps the most important question is what would be an appropriate level of minimum wage. Although there are recommendations in the latest EU Directive on adequate minimum wages to ensure this adequate level, a balanced approach is needed, as the minimum wage is a redistributive tool that has both benefits and costs.

While initially, in many countries, the concept of a minimum wage was directly "associated with the concept of providing an adequate living wage, today this notion is transformed into the concept of an adequate minimum living wage." (Belser and Sobeck, 2012)

2. Literature review

Although protection against poverty was one of the main functions and objectives of the minimum wage, other functions were added later.

Belman and Wolfson have underlined that the support provided by the minimum wage is underlined by the fact that it helps to improve the lives of the most vulnerable in the labour market. (Belman, 2014, p.21)

Bauducco and Kaniak studied the quantitative macroeconomic impact of raising the minimum wage on employment, the stock of capital and the wage distribution and found that a moderate increase in the minimum wage barely affects employment, a compression on the wage distribution and a positive effect on wages more. (Bauducc and Kaniak, 2018, p. 11).

Economic theory predicts that a minimum wage can contribute to growth and employment if some scenarios are taken into account. For example, in the case of a monopsony, a mandatory minimum wage (i.e. one set above the monopsony equilibrium level) can increase the number of people employed in the firm.

A popular and convincing argument in favor of raising the statutory minimum wage is that the higher the minimum wage, the more it will reduce poverty. While this is supported by theoretical research, the effects are not the same in practice. For example, in the informal sector, where workers are not effectively covered by minimum wage legislation, especially in developing countries, the effect is the reverse, meaning that poverty tends to become more prevalent in the informal sector (Gindlin, 2018, p. 1).

In the current economic situation, European policy places a strong emphasis on the relationship between national wage developments and international competitiveness, which means that wages should evolve in line with productivity in order to ensure the stability of unit labour costs, otherwise increasing minimum wages could have an effect on inflation, "because companies, employing workers paid at the minimum wage, may increase their prices after an increase in the minimum wage"(Macias and Soriano, 2013, p. 6).

The same was supported by the authors Belser P., Sobek K. who found in their study that "if the minimum wage is set at a sufficiently high level, it can increase the earnings of low-paid employees, helping to reduce the number of poor employees, reduce the gender pay gap and reduce wage inequality. If set too high, however, the minimum wage can be counterproductive, causing price inflation, affecting the workforce and proving unworkable for small and medium-sized enterprises". (Belser and Sobek, p. 3).

Analyses of the minimum wage in Romania are based on several sources of data both by researchers and by specialised state bodies.

Pantea examined the effect of minimum wage increases in Romania on regional employment over the period 2008-2016 and found that "on average minimum wage increases had an insignificant effect on employment over the period analyzed." (Pantea, 2020, p. 3)

Other researchers have studied the impact of minimum wage increases in Romania on average wages, income distribution, inflation, employment over the period 2013-2016 and found that employment increased, mainly at the minimum wage level, which contributed to a more balanced wage distribution and a relatively limited impact on CPI (Consumer Price Index) inflation and economic growth of average wage increases as a result of minimum wage increases. (Heemskerk, Voinea and Cojocaru, 2018, p. 4)

J.J. Sabia studied whether there is a relationship between minimum wage increases and gross domestic product in Romania and found that a 10% increase in the minimum wage is associated with a 1% to 2% short-term decrease in GDP generated by lower-skilled industries compared to higher-skilled industries. It also found no evidence that minimum wage increases were associated with changes in GDP (Sabia, 2015).

It was also investigated based on a regression model what is the impact of labor productivity and minimum wage adjustment in Romania, the results showing that a 1% increase in productivity induces a 0.74% increase in the minimum wage. (Antonie, Cristescu and Catanicu, 2010, p. 6).

Another study conducted by Davidescu and Schneider on the existence or not of a relationship between the underground economy and the minimum wage in Romania, shows that during the period 2000-2015 the Romanian underground economy decreased until 2008 to a value of about 27.8 percent of the official GDP, but in the short term the results obtained indicate that there is no effect between the increase of the minimum wage and the reduction of the underground economy (Davidescu and Schneider, 2017).

Since 2016, these studies have been complemented by the analyses constantly carried out by the working group (made up of experts from the following institutions: the National Forecasting Commission, the Ministry of Public Finance, the Ministry of Labor and Social Protection and the National Institute of Statistics) set up at government level to draw up the impact analysis on the minimum wage in order to base a transparent decision by the Romanian Government to adjust the minimum wage. As a result of these impact analyses, it was found that "increases in the minimum wage can decrease the relative poverty rate among employees paid at the minimum wage and increase employee motivation as they put more effort into their own work tasks after certain wage increases, thus increasing the level of labor productivity." (INCSMPS, 2016, p. 56) Despite the fact that, in general, the impact of an increase in the gross minimum wage is positive on the target category to which it is addressed, due to the fact that this increase is intended to maintain the purchasing power of employees, the working group formed in the Office of the Prime Minister of Romania recognized in the study conducted in 2020 that in order to achieve the objective of reducing poverty and improving the living standards of the low-income population, the minimum wage policy is not sufficient, and it is necessary to implement public policies, mechanisms and complementary measures that can have the effect of increasing income. (INCSMP, 2020, p. 1) Experts also continue to support the usefulness of the minimum consumption basket as a tool to assess poverty at a given point in time (INCSMP, 2023, p. 20)

3. Research methodology

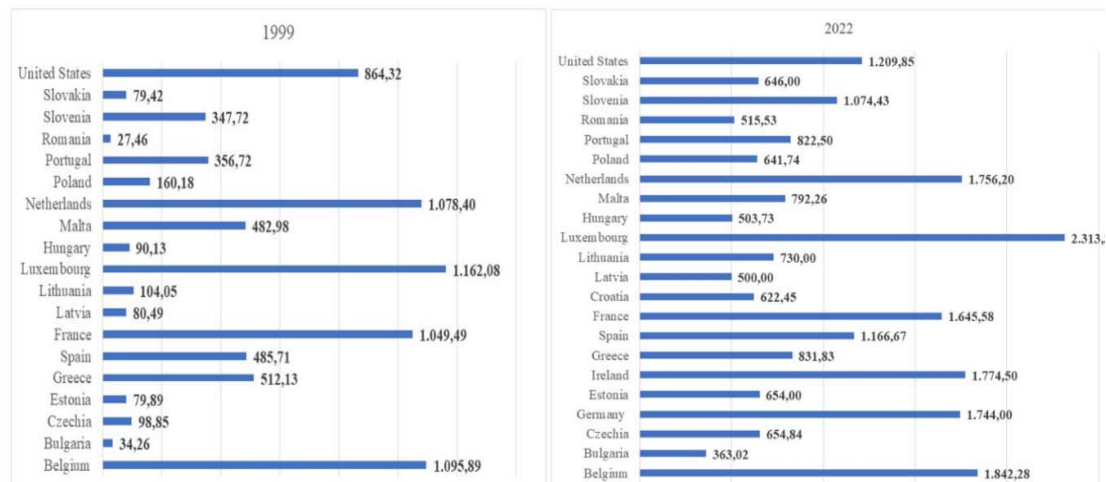
The research methodology was mixed, combining qualitative and quantitative analysis. The quantitative analysis aimed at collecting and interpreting data by comparing them both at national level and among EU member countries, so that the conclusions drawn in this article are in line with the research objectives. Another objective of the paper was to document the existing studies and legislative provisions on the basis of decisions on the adjustment of the minimum wage in Romania and the dynamic effects of these adjustments according to the objectives pursued by the government during the period under analysis: reducing the risk of poverty, reducing the number of employees paid the minimum wage, improving the standard of living.

5. Findings

Minimum wage setting is a labor market regulatory tool in all European countries, but the level of the minimum wage and the procedures and means used to set it differ considerably. Thus, in Europe, two minimum wage regimes can be distinguished: universal and sectoral. (Schulten, 2014)

All EU countries have set some form of minimum wage threshold which is either regulated by the government (the legal minimum wage) for 21 member states: Belgium (1975), Bulgaria, Czech Republic, Germany (from 1 January 2015), Estonia (1991), Ireland (2000), Greece (1991), Spain, France, Croatia (2008), Latvia (1991), Lithuania (1990), Luxembourg, Hungary (1991), Malta, Netherlands, Poland, Portugal (1974), Romania (1949), Slovenia (1995) and Slovakia (1991), or collectively agreed (through collective agreements), as is the case in 6 Member States: Italy, Austria, Cyprus, Denmark, Finland and Sweden. Cyprus has set a statutory minimum wage only for a few professions where employees have little negotiation power. The highest minimum wages in the EU in 2022 are in Luxembourg (€2,313), Ireland (€1,774) and Germany (which introduced the national minimum wage from 1 January 2015), and the lowest in Bulgaria, Latvia and Hungary, with Romania being into the group of countries with a minimum wage between €500 and €1,000.

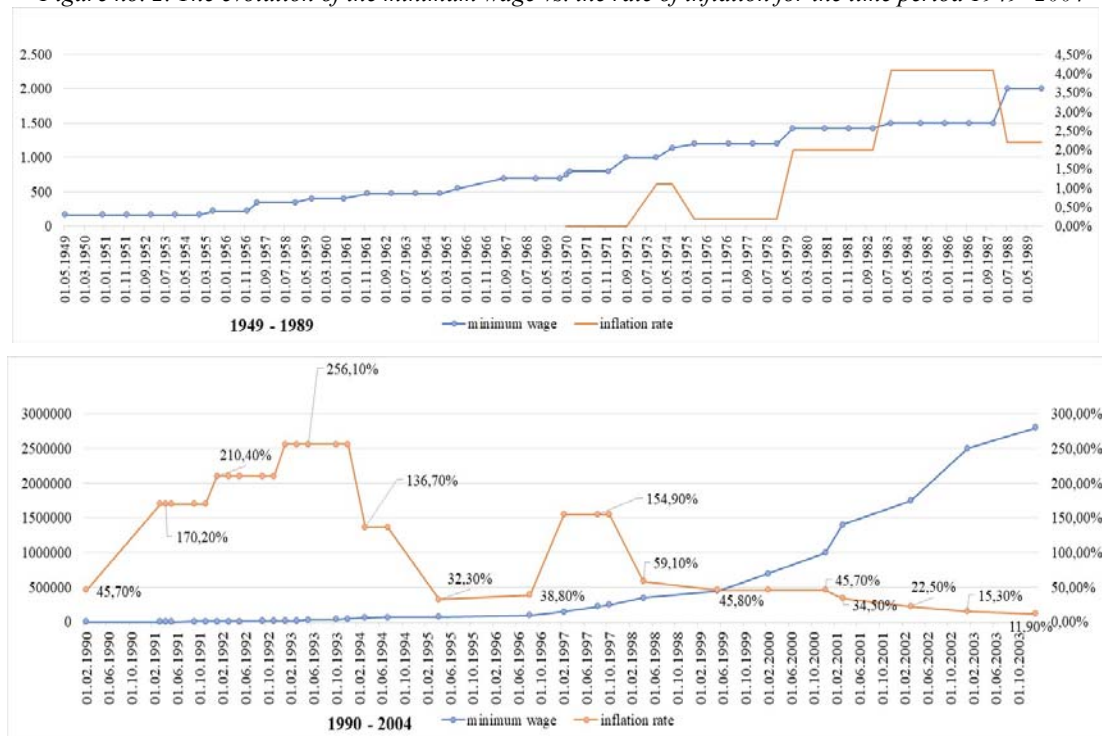
Figure no. 1. The evolution of the minimum EU wage for the period 1999-2022



Source: Adapted by author from: <https://ec.europa.eu/eurostat/statistics>

Analyzing figure no. 1 one can find that in 2022 the minimum wage in EU Member States ranged from 363 euros per month in Bulgaria to 2,313 euros per month in Luxembourg, compared to 1999 when the minimum wage ranged from 27.46 euros per year (Romania) to 1,162.08 euros per month in Luxembourg. In Romania the minimum wage level was and is set for all employers by government decision, after consultation with trade unions and employers. The gross minimum wage at country level was first introduced in 1949 for a normal working day of 8 hours a day, 40 hours a week, Romania being the first of the countries that joined the EU to introduce a legal minimum wage, followed by Spain, Bulgaria, the Netherlands, Germany being the last country to adopt the minimum wage in 2015.

Figure no. 2. The evolution of the minimum wage vs. the rate of inflation for the time period 1949 -2004



Source: INSSE

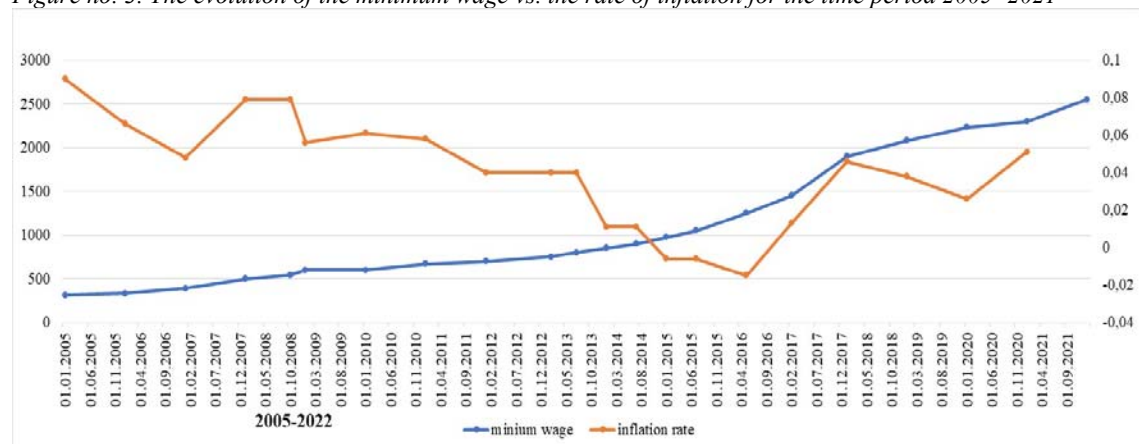
Figure 2 shows that from 1949 to 2005 the minimum wage was adjusted 45 times, with the pace of adjustment in the early years being rather slow but covering the increase in purchasing power. Since 1991, the Romanian government has increased the minimum wage rapidly, adjusting it six times a year, due to the accelerated rise in inflation, which this year reached a threshold of 170.2 per cent, the historical maximum being reached in 1993, when the inflation rate was 256.1 per cent. During the period 1991-2005, when inflation remained high, the gross minimum wage in the country increased by more than 154.9 percent compared to 1991, the unemployment rate increased by 73 percent and the poverty rate reached 33.8 percent of the total population, the threshold being equivalent to 60 percent of the average monthly consumption expenditure for an adult. Since 2000, the government has established, by Emergency Ordinance No 217/2000, that the adjustment of the gross minimum wage in the country is based on the value of the minimum monthly goods basket for a decent living.

The structure and components of the minimum monthly consumption basket for a decent living for a family consisting of two employed adults aged 35-45 and two dependent children aged 12-14 and 8-10 respectively are established by government decision, with the value of the minimum consumption basket for a decent living being established quarterly by the National Institute of Statistics and approved by government decision. The minimum monthly consumption basket for a decent living set by the government covered only the expenditure necessary to cover the general biological and social needs existing at a given time, with food accounting for 51.3 percent of the total amount.

The analysis showed that “the structure of the minimum consumption basket established by the government was deficient in a number of ways, such as: the lowest prices were taken into account without taking into account the sometimes significant differences in the quality of products, the duration of use of clothes was not appropriate to reality, there was a lack of medical expenditure, except for medicines, and there was a lack of expenditure on childcare”. (Guga, Mihailescu and Spatari, 2018, p. 5). The last indexation of the minimum basket was in the second quarter of the year 2003, following that, starting from 2004 the approval to be removed by law, and the minimum basket was removed from the basis of the country's gross minimum wage.

A study carried out by the Romanian Economic and Social Council shows that the mismatch between the gross minimum wage and this minimum standard has led to an increase in the number of people working but living on the poverty line (ETUC, 2014). According to EU standards, you are at risk of poverty if your usable income is less than 60% of the median usable income (per employee) in your country. Romania has been ranked the first in the EU since integration and so far in terms of the share of those working and at risk of poverty in the total employed population.

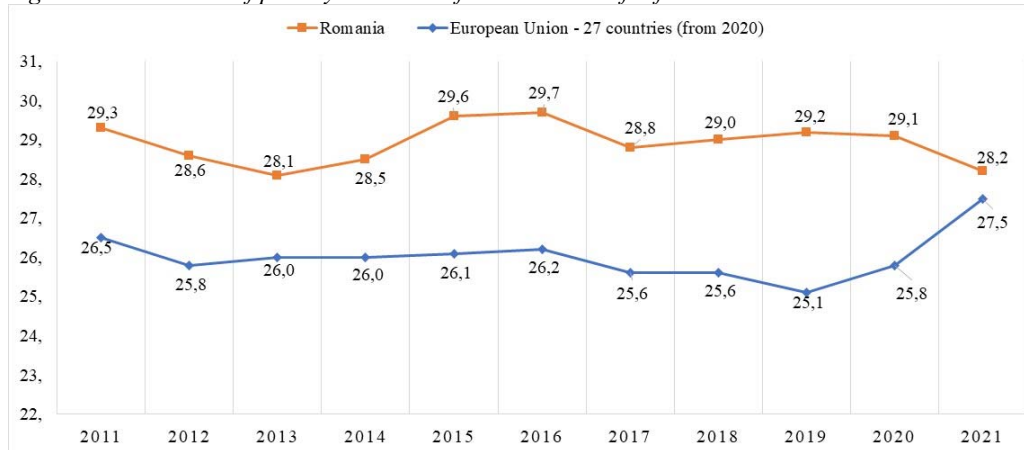
Figure no. 3. The evolution of the minimum wage vs. the rate of inflation for the time period 2005 -2021



Source: INSSE

Figure 3 shows that, from 2005 to 2021, the Romanian government substantially increased the minimum wage in order to help low-income workers, this increase covering the rapid pace of inflation starting from 2015.

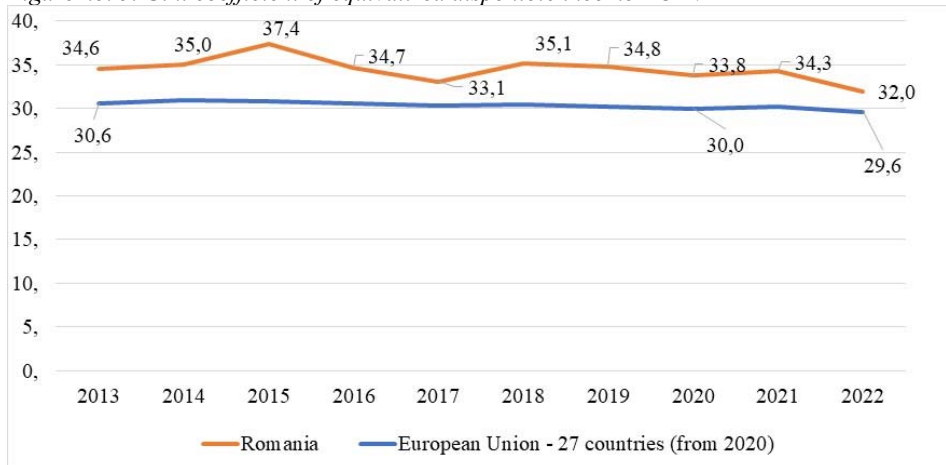
Figure no. 4. The rate of poverty risk rate before social transfer for Romania and EU-27



Source: Eurostat

We can see from Figure 4 that the situation in Romania worsened in 2015 when, for the first time more than 29.6% of Romanian workers were at risk of poverty. The situation then improved in 2021 when the risk of poverty reached 28.2%, but we continue to have the highest share of employees at risk of poverty in the EU, exceeding the EU27 average by more than 3 percent.

Figure no. 5. Gini coefficient of equivalized disposable income EU 27



Source: Eurostat

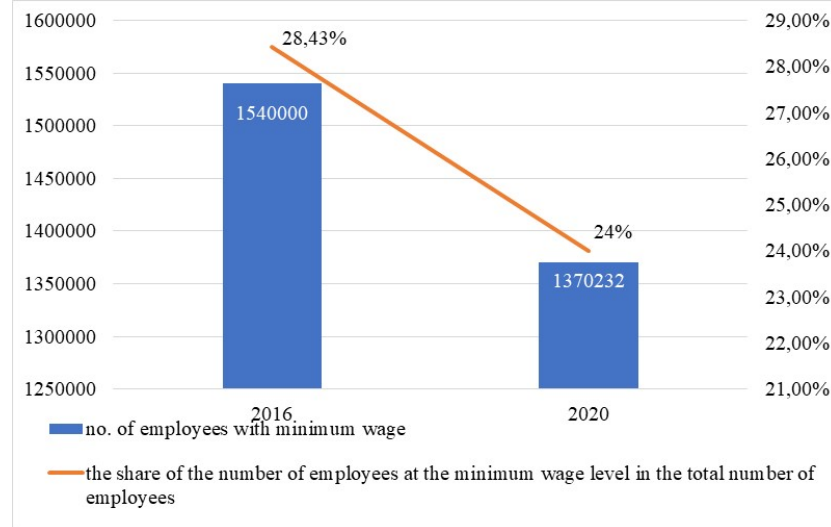
Concerning the inequality of income distribution between members, the Gini index in 2008 was about 34.6% (4 percent more than the EU-27 average), recording a steady downward trend since 2019, reaching a minimum of 32% in 2012. In the period of economic recovery, the Gini coefficient tends towards a slight increase (37.4% in 2015), thus widening the gap between population incomes, but less than at the beginning of the period analyzed.

Until 2017, employees who were unskilled for the occupied position were the only ones who were paid at the level of the gross minimum wage, while for the other occupational levels the remuneration was based on certain ranking coefficients that applied to the level of the gross minimum wage in the country. In 2013, the last National Collective Labour Contract in Romania was repealed, which regulated the application of hierarchical coefficients in the remuneration of employees according to the level of training required to apply for a job. The removal of the hierarchical coefficients led to the application of the regulations for the remuneration of employees in conformity, i.e. each employee, regardless of the level of training required for the job, was paid at the level of the minimum gross wage in the country. However, the share of the number of employees paid at the level of the gross minimum wage in the country as a proportion of all employees was 24.4 per cent in 2014

compared to 26.85 per cent in 2006, down by 9 per cent as many companies continued to apply differentiated pay according to the level of training and experience required for the job, especially in the case of newly hired employees.

By approving the National Strategy on Social Inclusion and Poverty Reduction and the Action Plan for the period 2022-2027, the Government aims to reduce the number of people at risk of poverty or social exclusion by at least 7% by 2027 compared to 2020.

Figure no. 6. The number of Romania minimum economy wage employees during 2016 -2020



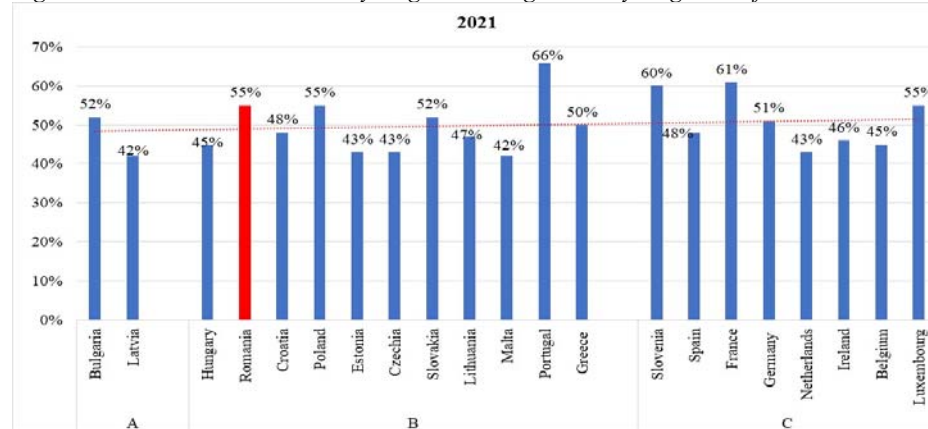
Source: Processed by author using: <https://mmuncii.ro/j33/index.php/ro/transparenta/statistici/date-statistice>)

We note from Figure 6 that in 2016 there were about 1.54 million active contracts at the minimum wage level, about 1.2 million employees with minimum wage incomes. The share of the number of employees at the minimum wage level in the total number of employees was 28.43% in 2016 compared to 24% in 2020, "this increase is justified by the faster growth of the minimum wage than the average wage earnings in the national economy" (MMFPSPV, 2016). In Romania in 2020 a 1370232 employees benefit from the guaranteed gross minimum wage, which represents a percentage of about 24% of the total number of active employees. In 2020, retail trade excluding motor vehicles and motorcycles, wholesale trade excluding motor vehicles and motorcycles, and land transport and transport via pipelines will account for more than 30% of employees paid at the minimum wage level, and are thus the main branches affected by the minimum wage increase measure. (INCSMP, 2020, p. 1)

In recent years, the Romanian government has made extensive use of the minimum wage as a tool to achieve the objectives set out in the Europe 2020 Strategy to reduce the number of people at risk of poverty and social exclusion by 580,000. In order to reduce the number of employees who are paid the minimum wage, the Romanian government issued in December 2021 the Emergency Ordinance no. 142 which will compel employers "to increase the wages of employees to the minimum wage, starting from 2024. Although the ordinance will apply from 2024, it also covered employment contracts for a minimum wage concluded on or after 1 January 2022, which must be amended within a maximum of 24 months in order for the employee to be paid a basic wage higher than the minimum wage on the economy in force." (GEO No. 142, 2021). Also, in order to combat the negative social consequences caused by price increases in 2022, as of 1 June 2022, the Romanian Ministry of Finance has regulated "the tax regime for the voluntary increase of the minimum wage per economy by the amount of 200 lei per month, with employees being exempt from income tax and mandatory social contributions". (MF, 2022)

An important criterion when assessing overall wage levels is the share of the gross minimum wage in gross average earnings. In assessing the adequacy of their existing statutory minimum wages, Member States may use a basket of goods and services at real prices as a reference, or they may set the reference to 60% of the gross median wage and 50% of the gross average wage.

Figure no. 7. The minimum monthly wage as average monthly wage ratio for UE countries



Source: Processed by author using: <https://stats.oecd.org/>

Figure no.7 depicts that, in 2021, minimum wages accounted for more than 60 percent of average gross earnings in just three Member States: Portugal (66%), France (61%) and Slovenia (60%). Minimum wages ranged between 50 percent and 60 percent of average gross earnings in 7 Member States: Luxembourg, Poland, Romania, Bulgaria, Slovakia, Germany and Greece. In 11 Member States: Spain, Lithuania, Ireland, Croatia, Lithuania, Belgium, Hungary, Latvia, Estonia, the Czech Republic and Malta, minimum wages were below 50 per cent of the gross average wage. From the analysis of the data presented, we see that, in most Member States, the adequacy of minimum wage is insufficient and/or there are gaps in the coverage of minimum wage protection, even though minimum wage protection exists in all EU Member States, either through legislative provisions (statutory minimum wage) and/or collective agreements.

5. Conclusions

The protection against poverty has been, over time, one of the main functions and objectives of the minimum wage, but other functions have been added. In the literature, the main functions of the minimum wage have been summarized as follows: supporting deprived groups; determining fair wages; setting a lower threshold of rewards as a tool against poverty, but also as a basis for the wage system; an instrument of macroeconomic policy. To these must also be added others: maintaining the purchasing power of employees, avoiding conflicts in the workplace, preventing unfair competition, supporting labor productivity and reducing social inequalities.

During the period subject to analysis, 1999-2021, we found out that the Romanian government substantially increased the minimum wage in order to help low-income workers, without this increase covering the rapid pace of inflation, which has resulted in a low standard of living and purchasing power for deprived people, as there are no other financial instruments to increase the income of this category. Although there was a normative act specifying that the adjustment of the minimum wage should be based on the minimum monthly basket of goods, even at that time, although the gross minimum wage per country was adjusted annually, the net salary per country obtained by an employee paid at the level of the gross minimum wage per country did not exceed 50 per cent of the minimum monthly basket of goods, which indicates that the income obtained is insufficient to ensure a decent living for the person concerned, further increasing the poverty rate.

From the analysis we've carried out, one can see that the increases in the minimum wage were made without objective criteria on the basis of which the increases were made. The absence of such criteria has created and will create a high degree of unpredictability for the business environment, as well as increasing poverty among employees. Furthermore, the lack of correlation between increases

in the minimum wage and the value of the minimum consumption basket may create social problems and further increase poverty among employees. As per the inequality of income distribution between members, the evolution of the Gini coefficient has shown us that it is partially correlated with the dynamics of the minimum wage.

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