

**ECONOMIC POLICY ESSAY ON THE INTRODUCTION OF STATUTORY MINIMUM WAGE IN
CYPRUS**

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The Introduction of statutory Minimum Wage in Cyprus

Abstract

The main objective of a minimum wage scheme is to ensure decent living conditions especially for low wage earners without generating economic distortions. Recent studies exhibit that the introduction of a minimum wage has various benefits, such as substantial reduction in wage inequality and social exclusion and reduced unemployment, especially amongst young people. As of January 1st 2023, statutory minimum wage will be in effect in Cyprus. It has been set at €885 upon recruitment and it rises to €940 after 6 months of continuous employment at the same employer. However, some parameters still need to be regulated for a smoother and more distinct system. For instance, the revision mechanism and the monitoring practices need to be specified as well as the hourly minimum wage needs to be defined. It is expected that the minimum wage introduction will have overall positive effects from a socioeconomic perspective.

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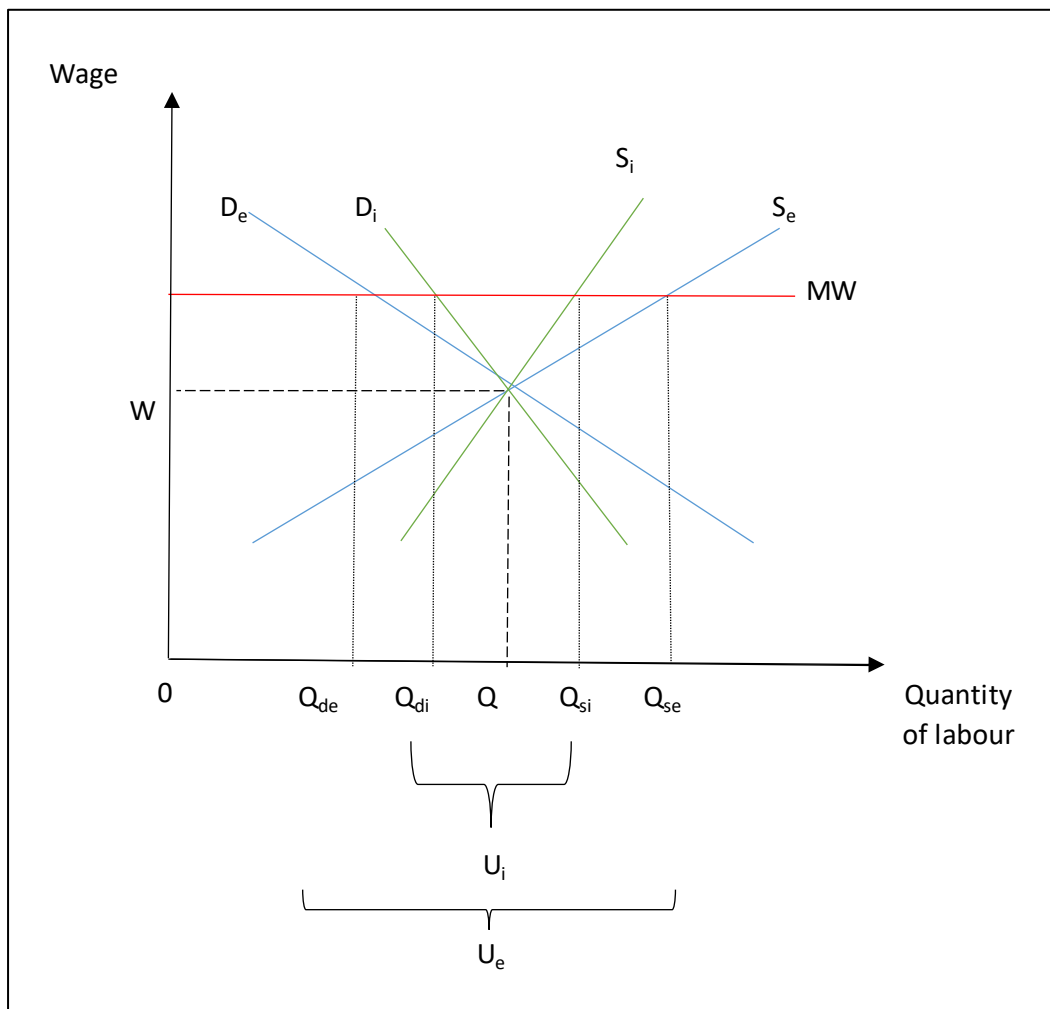
1. Background

There is no consensus in one direction regarding the socioeconomic benefits and drawbacks of Minimum Wage (MW). Supporters on the one hand assert that it prevents the exploitation of workers, while its opponents on the other hand suggest that it reduces employment and destroys jobs.

According to the mainstream economic theory, if the labour market is assumed as perfectly competitive, setting the MW above the equilibrium point, decreases employment, due to the fact that more labour will be supplied by workers while less employment will be demanded by employers, impacting a labour supply surplus. In general, the higher the point the MW is set and the more elastic the labour supply and demand curves are, the higher the unemployment rate after the introduction of the new higher MW (Mitsis, 2015).

As it is depicted in Figure 1 below, if the MW is set above the equilibrium point W , in case of elastic supply (S_e) and demand (D_e) curves, then the unemployment (U_e) is higher than in the case of inelastic supply (S_i) and demand (D_i) curves with unemployment (U_i).

Figure 1 - Introduction of Minimum Wage in a Fully Competitive Market



If the MW is set at a very high level, an upward wage pressure is possible to be shaped due to adjustments both for MW workers but also for higher earnings workers. The subsequent increase in the operational costs of enterprises, could generate a loss of competitiveness in the economy under question. The increase in this case mainly affects small and medium sized enterprises with the risk of reducing their activities and for some to even terminate their activities. Additionally, the adoption of a MW is likely to lead to an increase in undeclared work at wages lower than the ones set by the MW, thus undermining its main objective (Cyprus Economy and Competitiveness Council, 2022).

There are, however, cases where the imposition of MW increases total employment, such as in monopsony markets where firms have significantly more power than workers. In this case, workers are being paid very low and this creates a distortion. For instance, the fast-food industry is considered a monopsony market, in the sense that it mainly employs unskilled young persons who do not have a variety of alternative employment options. By introducing a MW, the above-mentioned distortion can be reduced and the sector is driven by increasing employment (Borjas, 2013).

Recent studies exhibit that the introduction of a MW does not lead to an increase in unemployment. On the contrary, it has substantial benefits streaming mainly in terms of attracting young persons into the labour market and thus, reducing the unemployment risk for this portion of the labour force, as well as combating economic inequality and the risk of poverty and social exclusion, which are essential tools to sustain social cohesion conditions (Cyprus Economic Society, 2022).

Nevertheless, the impact of the introduction or extension of a MW needs to be considered more broadly than for simply its employment effects (Christofides, 2021). The main objective in the adoption of a MW should be to safeguard workers from low wages and ensure decent living conditions for them without threatening the competitiveness and macroeconomic stability of the economy and thus, creating other distortions whose negative effects outweigh the benefits of MW adoption (Cyprus Economy and Competitiveness Council, 2022).

2. Analysis

2.1 EU Directive

The issue of the MW has been discussed within the EU as a measure to combat the working poor population. More specifically, in October 2020, the European Commission proposed a directive seeking to improve the adequacy and increase the coverage of MW, while also strengthening collective bargaining as the main instrument to ensure fair wages and decent working conditions. It is the first time that the European Commission has initiated legislative action on MW protection, leaving Member States to define their own specific MW levels. However, it is recommended for an indicative target of 60% of the national median wage and a periodic revision of the MW at regular intervals, based on an institutionalized mechanism. It is proposed that the criteria should include at least the purchasing power, the general level of gross nominal wages and their distribution, the growth rate of gross wages and labour

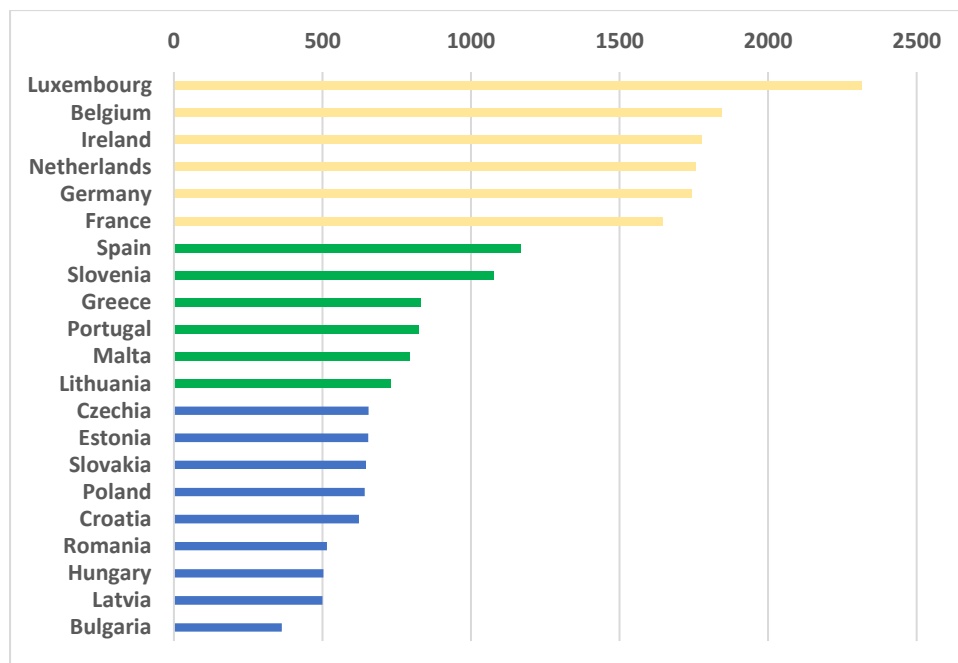
productivity developments. The final text of the directive on adequate MW was adopted by the Council on 4 October 2022 and Member States now have two years, until 15 November 2024, to comply with the new directive (European Parliament, 2022).

In the same way, in the context of the European Pillar of Social rights, the EU wishes to ensure that employees receive a wage that is essential to guarantee adequate working and living conditions for them and their families, as well as to build fair and resilient economies and support inclusive growth (European Parliament, 2022). It is vital to underline that the MW' value is not only the amount in money terms but also the institutional setup each country opts to pursue.

2.2 Current Status in the EU

Up to 2022, only 6 EU countries (Austria, Cyprus, Denmark, Finland, Italy and Sweden) did not have a national statutory MW system in effect. Cyprus used to have MW for different occupations before the announcement of the MW introduction in August 2022, while the other 5 countries have MW set within collective agreements. Especially, in Denmark, Sweden and Finland, where collective agreements are the main mechanism for setting MW, the resulting coverage is around 80%-90 % of employees (European Parliament, 2022).

Figure 2- Monthly Minimum Wages in EU as of 2nd Half of 2022



Source: Eurostat

EU countries with statutory MW can be divided into 3 clusters; the first group (in yellow) consists of Luxembourg, Belgium, Ireland, Germany and France with MW set up to €1500, the second group (in green) consists of Spain, Slovenia, Greece, Portugal, Malta and Lithuania with MW between €700 and €1500 and the third group (in blue) consists of Czechia, Estonia, Slovakia, Poland, Croatia, Romania, Hungary, Latvia and Bulgaria with MW below €700. The

cluster division is also consistent with the geographic location of the countries; the western countries have the highest wages, the southern follow and lastly the eastern ones have the lowest MW. If Cyprus' national MW was effective as of the 2nd half of 2022 (and not in the beginning of 2023), it would have been classified in the second group between Slovenia and Greece in Figure 2.

2.3 The case of Cyprus

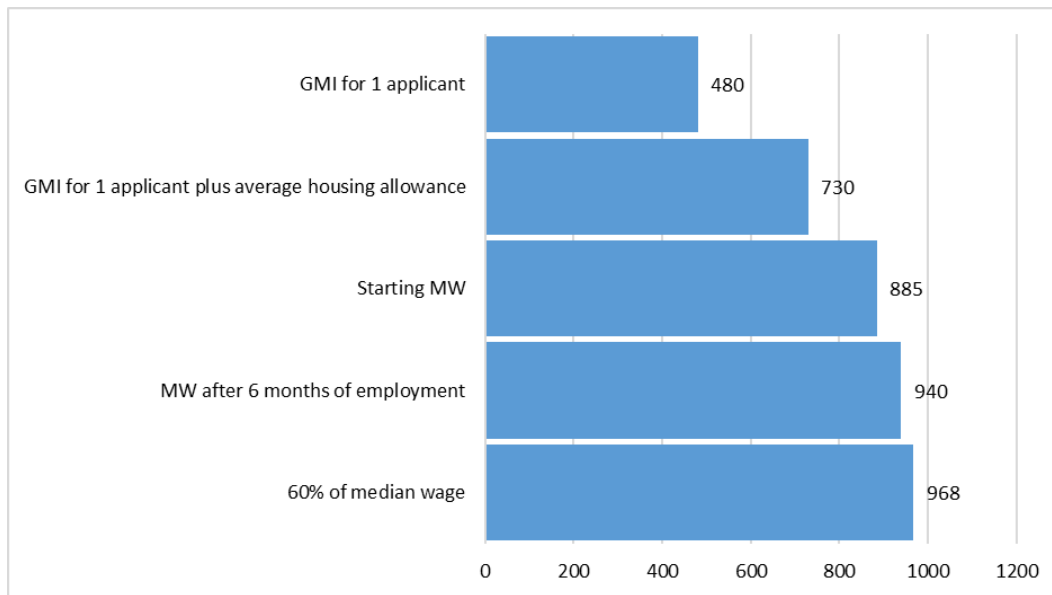
In Cyprus, a national MW was not introduced until recently. Legally binding wage minima existed for 9 occupations such as shop assistants, nurses' assistants, clerks, hairdressers and nursery assistants and for 13 occupations in the hotel industry and amounted between €870-€1070. For occupations that are unionized, collectively bargained 'indicative' starting salaries are decided.

After several months of discussions, the introduction of MW was announced on 31st August 2022. The level of the wage has been set at €885 upon recruitment, which corresponds to 56% and 44% of the 2020 Cyprus Statistical Service (Cystat) annual earnings median and mean respectively. The MW rises to €940 after 6 months of continuous employment at the same employer (which corresponds to 60% and 47% of the 2020 Cystat median and average respectively based upon Social Security Services database). The 2020 statistics were the most recent available data at the time the decision was made.

According to the 2021 Cystat median and average, which were published afterwards, the starting salary of €885 corresponds to 55% and 43% and €940 to 58% and 45% of median and mean respectively. As shown in Figure 3, 60% of median wage corresponds to €968 which is slightly higher than the MW set. Furthermore, the Guaranteed Minimum Income scheme (GMI) for a single beneficiary is €480 and when the average housing allowance is added, it is raised to €730¹ on average. MW is higher, thus there is increased incentive for GMI beneficiaries to seek a job. In addition, MW workers are not income taxed as they do not fall into the minimum chargeable income bracket, which is at €19,500 per year.

¹ Based on calculations from Welfare Benefit Management Service of the Deputy Ministry of Social Welfare.

Figure 3 - Minimum Wage in Cyprus



The Cyprus MW will cover all economic occupations and sectors with the exception of domestic, maritime, agricultural and livestock workers. Furthermore, workers employed in the hotel industry are also exempted since they are covered by the Minimum Wage Hotel Industry Order (2020). No price indexation (COLA) is included. Its implementation starts from 01/01/2023, it will be reviewed in 2024 (1 year after its introduction) but the regular review is expected to take place every 2 years. The Department of Labour Relations and the Joint Inspection Service of the Ministry of Labour and Social Insurance, will be responsible for the implementation, including inspection of workplaces and filing cases to Court in case of non-compliance of the MW.

2.4 Macroeconomic Impact

According to a study contacted by the Joint Research Centre (JRC) of the European Commission, when EU Member States set their MW at 50% of their national gross average wage and 60% of their national gross median wage, the reduction in total employment is estimated to 0.4%. Some other interesting results of the study are:

- the average reduction in work poverty is estimated to 12%–13%
- the average reduction in wage inequality is approximately 8%–10%
- the average reduction in gender pay gap is around 5%.

Although wage increases are substantial for beneficiaries, increases in the aggregate wage bill are generally insignificant, as are the possible negative effects on employment. In general, empirical studies suggest that the effects of MW on employment, working hours or other related labour market variables remain modest (Grünberger, et al., 2021).

Regarding the government budget balance, research indicates that MW increases are estimated to have limited impact upon public finances. The overall improvement in government finances is below or close to 0.1% of GDP in the scenarios with MW at 50% of the

median or 40% of the average wage, reaching 0.4% of GDP only in some cases where MW have increased to 60% of the median wage and 50% of the average (Grünberger, et al., 2021). There is no explicit projection on Cyprus as there has been no available data.

According to a preliminary exercise of the Ministry of Finance, it is estimated that around 63,500 workers will be benefited from the introduction of the MW as from 1st January 2023². As a percent of the total labour force (Cystat 2021 data – national accounts terms), it is estimated that around 14% employees will be affected. Regarding the impact of the adoption of the statutory MW on public finances, it is expected that a positive net impact will come through the increased revenue of the Social Security Fund and of the Health Insurance Organization, estimated at around 0.1% of GDP.

3. Concluding Remarks

The regulation of the MW in Cyprus is generally aligned with the guidelines of the European Directive. It has not been clear yet, what the revision mechanism and methodology will be. In most cases in the EU, the MW rates are reviewed and reset once a year, although some countries have more than one revision in a year or amend them less often. This regular process usually includes consultation or negotiation, recommendations with expert committees, negotiation between the social partners and in the end unilateral decisions by the governments (Eurofound, 2022).

It would have been better if the MW was set on an hourly rather than a monthly basis, as is the practice in several EU countries (Cyprus Economic Society, 2022). This omission may be taken into advantage by employers. For example, two MW workers may both earn €940 but one may work for 38 hours per week and the other for 48 hours per week. Also, there is no definition in the law about the full-time employment equivalent in hours. The law defines only that the maximum number of working hours per week which is 48 hours³. On the other hand, it is difficult to alter the status-quo as the hours worked in each sector are either determined by collective agreements or by contracts.

Many analysts suggest that, the adoption of the scheme of the MW is less efficient in economies with an extensive volume of undeclared work. Cyprus' shadow economy was estimated by the International Monetary Fund (IMF) at 30,4% of GDP for 2016, which was considered quite high in relation to the other European Countries (Kelmanson, et al., 2019). It is therefore significant that the introduction of the MW is combined with measures to fight undeclared work. As a matter of fact, in Cyprus the amount of information employers was required to declare was limited. A new information technology system, though, named "Ergani/Εργάνη", has been introduced on September 2022 through which employers are

² MoF calculations based on the "Percentage Distribution of Employees by Monthly Gross Earnings and Sex, 2019" database, Cyprus Statistical Service. The 2019 database is the most preferable because the 2020 and 2021 wage subsidisations schemes might change the real earnings distributions. It is assumed that there will be full adjustment to the MW (e.g. no hours worked change and no unemployment increase).

³ Ο Περί της Οργάνωσης του Χρόνου Εργασίας Νόμος του 2002 (63(I)/2002).

required to upload information about hiring, termination and employment conditions, such as working hours of their employees. It is expected though that this system, if audit is sufficient and efficient, will reduce undeclared work. In general, labour inspections and monitoring practices should be intensive.

Another challenge regarding MW introduction is the COLA. Based on the European Commission Autumn forecast, inflation was expected to increase to 8% for 2022 and decelerate to 4,2% for 2023 (European Commission, 2022). Thus, real wages will be decreased if nominal wages will not be adjusted. In regards to the EU countries, it appears that only around half of the countries with statutory MW take inflation into account or changing living costs when setting rates (Eurofound, 2022). This is an issue which is still being under discussion in Cyprus.

It is crucial to state, as well, that the GMI scheme is considered to be a safety net for unskilled and low-wage earners. It plays the role of income of last-resort and the support aimed at protecting households from poverty and deprivation. With the introduction of the MW, it is expected that GMI recipients will be more motivated to work as the MW salary will be higher than the salary they were offered before. As a result, GMI and other social benefits dependence is likely to be mitigated.

Lastly, the MW introduction will contribute to labour piece and it is a step forward to a better welfare state. However, it is not a panacea to poverty and income inequality; it has to be implemented in conjunction with other policy measures in a way to maintain and enhance social cohesion without deteriorating public finances.

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