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Labour Market Performance in the New Member States of the European Union in the Context of the Current Crisis

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Abstract: The global economic and financial crisis has generated a series of adjustments both in terms of macroeconomic policies and especially in terms of real economies developments. One field with major impact on the economies development, especially in this period, is the labour market. Referring to the labour market, the results at the global, regional and local levels appear extremely negative. Thus, only in the European Union (EU27) approximately 23.248 million men and women were unemployed in November 2010, of which 15.924 million people in the euro area, according to Eurostat. At the end of 2010, the EU27 unemployment rate was 9.6% and in the euro area it reached no less than 10%. Lately, in the labour market, although one can observe some temporary improvements, from month to month, the situation remains critical due to the delay in creating new jobs. In this context, the paper aims to capture, through a case study, the developments of EU New Member States (NMS) labour market, before and after the emergence of the crisis. The obvious and immediate implications of the crisis on the labour market are the increase of unemployment, especially the long-term unemployment, and the more difficult recovery of the NMS labour market, compared with euro area countries.

Keywords: unemployment rate; employment rate; public policy; Central and Eastern European Countries

1 Introduction

In late 2008 and early 2009, the international effects of the turmoil unleashed from the United States one year ago have been fully perceived on every continent, turning into the worst international economic and financial crisis after the Great Depression. Being in a catching-up process, the countries from Central and Eastern Europe, generally with large external and fiscal-budgetary deficits, felt strongly the effects of the crisis, through a sudden process of consumption and investment contraction, on the grounds of dramatic internal and external liquidity shrinkage and of the collapse of the entire society confidence. In this context, almost all new EU member states registered dramatic declines of real GDP (except Poland), with serious implications on the economy as a whole, and especially on these countries' labour market.

In the period preceding the onset and the manifestation of global financial and economic crisis, in all NMS, the labour market has registered, as the entire economy, an expanding phenomenon and even an overheating one, amid credit and trade expansion, strengthening of the prices and income convergence

process, also maintaining a high level of investment. However, simultaneously, it has been accumulated a number of factors with significant negative impact of which we state: uncontrolled growth of wages, in 2007-2008, higher than labour productivity gains; adverse demographic development; increase of unit labour cost; major imbalances of the educational system; exposure to poverty risk of certain categories of population; migration of well qualified workforce etc. Therefore, almost all negative factors accumulated prior to the crisis have made their presence felt once the crisis spread over Europe, and especially over NMS. As a result, the paper proposes a thorough study of the issue of economic and financial global crisis impact on the new EU member states labour market.

2 Labour Market and its Performance in the NMS before and after the Crisis

Although the global economic and financial crisis has brought some favourable adjustments, most of its effects on the labour market can be considered dramatic for the majority of NMS, in particular for the Baltic countries. Thus, the employment rate decreased in 2009 compared to 2008, in Estonia from 69.8% to 63.5%, in Latvia from 68.6% to 60.9%, in Lithuania from 64.3% to 60.1%, in Bulgaria from 64% to 62.6%, in the Czech Republic from 66.6% to 65.4%, in Hungary from 56.7% to 55.4% and in Romania from 59% to 58.6%¹. Poland is the only country from NMS, which recorded a modest increase in employment in 2008-2009.

Concurrently, in 2009, unemployment registered a tremendous growth in the NMS, exceeding twice the amount recorded in 2008 in the Baltic countries and increasing less robust in the Czech Republic, Poland, Hungary, Romania and Bulgaria. Therefore, in 2009, the strongest increases in unemployment were observed in Latvia (to 17.1% from 7.5% in 2008), in Estonia (to 13.8% from 5.5% in 2008) and in Lithuania (to 13.7% from 5.8% in 2008), while in Poland, Romania, Bulgaria, Hungary and the Czech Republic the unemployment increased with a rate below 3%. It is worth noting that, in 2010, the unemployment rate has continued to grow temperately in Hungary, Poland and the Czech Republic. In Bulgaria, in 2010, the unemployment rate increased with 3.1%, reaching 9.9%, however, it did not exceed the level of 11.2% marked by Hungary². Such a negative development of employment makes the ambitious targets of the "Europe 2020" to be unattainable in the medium term, even for those countries which did not record significant difficulties in this regard, before the emergence of the crisis.

Referring to Hungary, the labour market situation was negative even before the crisis, given the adjustment measures of the fiscal and budgetary deficits; however the explanation for the poor evolution of employment and the increase of unemployment in the pre-crisis period finds its roots much deeper than those generated by the previous reforms. Thereby, the generous social welfare system, the shortage of labour supply among young people, mothers, elderly population, unqualified people and disadvantaged categories, the low education and qualification of the population, the insufficient expansion of the active labour market policies, the long-term and persistently high unemployment, the high taxation system, the disregard for labour, the low internal mobility of the working age population are just a few aspects that shape the real issues of the labour market in this country. These negative factors are found in different proportions in Romania, Bulgaria and in the Baltic countries, but are much less present in Poland and the Czech Republic. If we refer only to the Baltic countries and Bulgaria, the major problems of the labour market are found mainly in: a low employment rate among adults without higher education, a high percentage of long-term

¹ Eurostat, 2011 February database.

² Eurostat, 2011 February database.

unemployment, especially a high share of male unemployment in the unemployment rate, but also a considerable share of employment in the black economy (in Bulgaria), based on a rigid legislation.

In general, in relation to the triggering moment of the crisis in the NMS, the growth of imbalances in the labour market has increased relatively quickly, amid the deepening of the recession, the decline of the employment in constructions and services, but also the accumulation of structural imbalances. The main concern is the growth and the persistence of long-term unemployment, which rose by more than two times in 2008-2009 in the Baltic countries and gained a persistent character, even if unaccompanied by increases as high as in the Baltic countries, in Hungary and Bulgaria¹.

Looking at the evolution of the employment growth rate relative to the GDP growth rate, in late 2009 and early 2010, we can say that for the more developed states in the NMS group, such as Poland and the Czech Republic, there is a similar trend to the EU27 average, meaning that the shock wave of the crisis, by affecting economic growth, acted with a certain delay on the labour market, which recorded less brutal and immediate effects than in the case of Latvia, Lithuania, Estonia, Hungary, Romania and Bulgaria.

The interdependence between the economic growth and the employment makes crucial the importance of a stable macroeconomic environment, favourable to the sustainable recovery of economic growth, for a more balanced labour market. In turn, a good labour employment plays a fundamental role in the development of NMS economies and especially in the catching-up process, compared with developed countries of the European Union.

The normalization process of the labour market situation is based on balancing the labour supply with the labour demand, namely adjusting the qualification of persons seeking employment with employers' requirements. It should be mentioned for the NMS, that not only the inappropriate labour supply structure is a real problem in this crisis period; the lack of an increasing labour demand absorption area is part of the problem, too. Thus, the restriction of the number of vacancies and the unemployment growth led, on the one hand, to a rising competition in the labour market, and on the other hand, to an increased difficulty for the unemployed persons to find a job. *A direct and visible consequence of the crisis is the unemployment rising and the transformation of a large part of the cyclical unemployment into a structural one.*

If we refer strictly to the labour demand imbalances that can lead to this adverse development on the labour market, we can mention: the need to restore the profitability of business and the corresponding adjustment of balance sheets, situation which implies further postponement of the rehiring and even additional layoffs; delays in restoring confidence in a rapid economic recovery; additional costs with taxes imposed on companies, due to the need of reducing budget deficits; and also the legislative changes, mainly intended for public sector restructuring, but with impact on the companies' normal functioning. If we analyze the evolution of harmonized unemployment rate in terms of correlation with inflation during the period 2008-2010, we find consistencies with the classical theory of negative correlation between the unemployment and inflation (see Figure 1).

¹ Eurostat, 2011 February database.

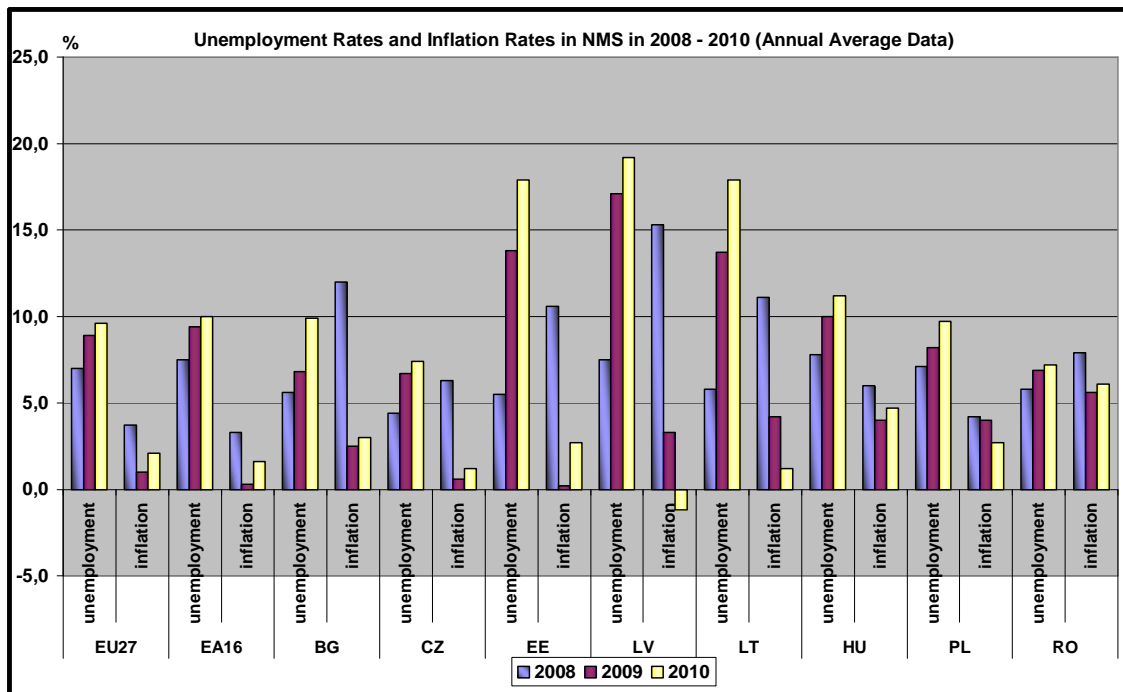


Figure 1. Annual Average Unemployment Rates and HICP Rates in NMS in 2008-2010 (Eurostat database)

We notice that, during the analysis period, in EU27 and in all NMS, the unemployment rate has increased considerably and this fact, although in the first phase led to a fall in inflation, in the coming period it resulted in an inflation rising, acquiring the U shape in EU27, euro zone, Bulgaria, the Czech Republic, Estonia, Hungary and Romania. At very high rates of unemployment (close to 20%) inflation becomes deflationary, as in the case of Latvia, which shows that inflation is indeed another facet of unemployment, with extremely serious implications for the present and the future evolution of the economy. However, most NMS with rising inflation seem likely to go through a process of stagflation (high unemployment, persistent inflation and an adverse GDP trend), which should concern all the national authorities and determine them to intervene through concrete measures for economic recovery. These measures should help to restart businesses, to increase employment and to improve living standards. Also, adjusting labour market structural imbalances in the NMS can help to diminish unemployment, to reduce poverty and to boost population growth.

Moreover, labour productivity represents, on medium and long term, one of the main supports of the economy's growth potential. In order to increase productivity, ensuring a favourable, stable, predictable and "friendly" economic environment is essential. This environment should encourage entrepreneurship, attract investments, contribute to the reduction of unit labour costs and attract considerable technological and human resources, offering the prospect of a sustainable economic growth. If we consider the crisis effects in the NMS, we can notice a massive decline in investments and capital capacity use.

Although it is expected a post-crisis recovery of the investment levels, a number of weaknesses in the business environment may further affect the economic performance of these countries. Among them, we mention: a still burdensome legislative environment, a relatively high length of time for closing or opening a business and also a high cost of these operations, an extremely complex method of taxation,

especially in the administration and collection of taxes, affecting in particular small businesses and start-ups, an inefficiency and lack of effectiveness of public administration, of the judiciary system, of supervisory and regulatory authorities, a lack of consistency of fiscal and competition policies, the corruption, a delay in public administration government restructuring, an insufficient transparency in the public procurement system, low levels of capital endowment and a modest overall productivity of inputs (especially in Bulgaria and Romania), a deepening of the disintermediation in credit financing and increasing difficulties in obtaining alternative sources of funding, an insufficient transport infrastructure development (in Estonia and Romania), a polarization of the direct foreign investments towards service and real estate sectors and last but not least, an underdeveloped capital market (especially in the Baltic States, Bulgaria and Romania).

In this context, if we look at labour productivity, we find, according to Eurostat, that in 2008 it has increased in Bulgaria, the Czech Republic, Lithuania, Hungary, Poland and Romania, but in 2009, it decreased in all new EU member states except Poland. In fact, Poland seems to have been able to take full advantage of the crisis because it has benefited and will further benefit from unit labour costs reduction, as the other NMS, but without any negative interference in labour productivity. In this regard, the analysis of labour productivity growth rate (per employee) together with real unit labour costs growth rate in 2008, 2009 and the forecast for the period 2010-2012, shows indeed a negative correlation accepted by the theory (see Figure 2). However, this correlation does not apply to Latvia and Hungary in 2009 and Romania in 2010, which demonstrates that these countries show deeper internal imbalances compared to other NMS.

For the period 2011-2012, the labour productivity growth rate is expected to be positive and increasing in all NMS, and if the wages growth rates will comply with developments in labour costs, they will be below the labour productivity gains.

With regard to the wage developments responsiveness in the crisis conditions, we can say that the NMS labour market is relatively flexible, earnings per employee having decreased in all NMS, but stronger in the Baltic countries and Romania, in 2009, compared with the previous year; in 2010 wages continued to decline but at a considerably lower pace, according to the statistics and national authorities. Theoretically, reducing labour costs, including wages, could have been a solution for maintaining or tempering the unemployment spectacular growth in the period from late 2008 until now, but it did not happen so (at least in the Baltic countries), indicating serious imbalances, rather structural, in the labour markets of these countries.

Thus, in 2009 and 2010, wage developments in these countries reflected the measures for reducing governmental fiscal-budgetary deficits and for adjusting the companies' balance sheets such as: the private or public sector wages cuts and wages freeze, the elimination of premiums and pay rises, the enforcement of unpaid leave, the payments postponement, the pension reforms, the adjustment of welfare systems costs, the reduction or the refusal of granting subsidies (including those for heating) and the series of legislative amendments to the Labour Code, in order to make more flexible and quick the entry and the exit of the labour market employees. Despite these measures, the economic recovery is sluggish and its effects in the labour market will be seen in a medium term horizon. In this respect, the creation of new jobs, both in the private and public sectors, is a difficult, lasting process, which takes into account people's and businessmen' confidence in the soundness and stability of the economies.

The factors that now delay the economic recovery, implicitly the employment, are represented precisely by those elements, which have stimulated the dramatic increase in demand and led to wage

increases in 2007-2008, in the pre-crisis period. If, before the crisis, these items had a positive effect on the economic growth, after the emergence of the crisis their effect became negative. Hereby, the sudden stop of lending growth, the serious cuts of employees' income, the tempering of budget deficits and the mistrust of the investors are just some elements that perpetuate the current situation in the NMS.

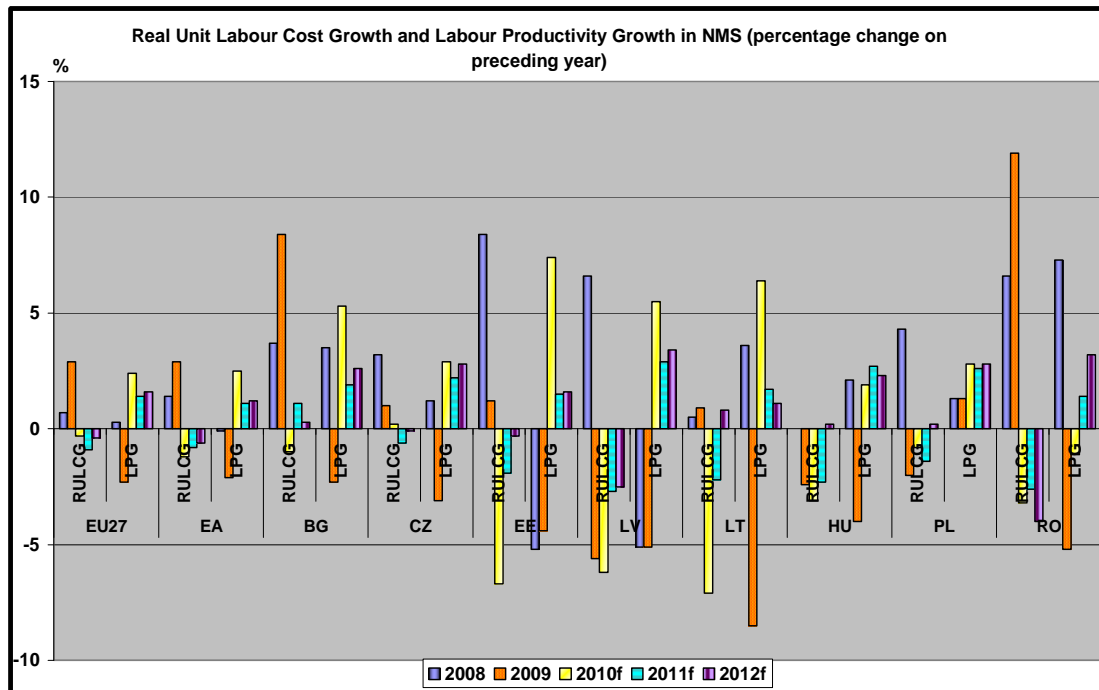


Figure 2. Real Unit Labour Cost Growth and Labour Productivity Growth in NMS in 2008-2012 (Eurostat database and European Economic Forecast, autumn 2010)

The employees' income adjustment measures had extensive implications also on the banking systems from NMS. Thus, simultaneously with the reduction of the population disposable income, there have also emerged pressures about the deterioration of the banks' portfolios quality, affecting the soundness of the banking system. Such a situation is actually normal, because of the defacement of the population perspective concerning the working place security and working earnings, which has led to the lower demand for credits, to the diminishing of households' marginal propensity for consumption and to the shift towards savings, as a preventive measure.

Referring to the labour market and social policies, one of the challenges of the NMS governments is to prevent the unemployment rising and its transformation into a structural one. To such development it can contribute, in a negative sense, the reduced regional and occupational mobility of the active population from these countries.

The demographic trends are not encouraging either, the aging population being one of the thorniest problems for the management of public policies at national and European level. Furthermore, the European guidelines for public policies, without a long-term vision, sustaining the idea of raising the statutory retirement age are only a short-term remedy for the major deficits of pension systems, in the absence of active measures to boost birth rates and employment.

3 Conclusions

In the period preceding the onset of global financial and economic crisis, in all NMS, the labour market has registered a growing and even an overheating phenomenon, also accumulating a number of factors of negative nature, such as: the downward trend of natural growth of population, the huge growth of earnings, exceeding labour productivity gains, the unit labour cost increase, the decoupling trend of education system from the real requirements of the labour market, the well-qualified labour migration, the unsatisfying social protection for the disadvantaged etc. With the outbreak of crisis in the NMS, the negative factors accumulated in the labour market have made their presence felt, leading, together with the GDP fall, to the tremendous growth of unemployment and to the decrease of employment.

In the surveyed countries, the low employment rates reveal the decoupling of labour force qualifications from the labour market requirements. An important factor in this respect could be the adequacy of the education system to the realities of labour demand, through boosting training and lifelong learning policies. Not accidentally, the companies considered that, along with the infrastructure development, skills development represents one of the most important factors for the operation and business growth. However, labour market policies should be complemented with structural policies to support economic growth. In this respect, there should be undertaken measures to enhance absorption capacity of new technologies, of foreign direct investment flows, of European structural funds, also increasing the correlation of researches results with the profile industries and to improve the functioning of network and retail industries.

Moreover, the persistence of structural problems in the labour market, as the professional disparities of qualifications and the low regional mobility, may hinder any positive effects on social and labour market policies. Therefore, active labour market policies are crucial for the post-crisis period. Thus, active labour market policies should focus on as many as possible target groups and the evaluation of these policy measures should take into account their outcome or their social impact and not their financial size. In this sense, for companies it is more motivating to have a stable economic environment for labour absorption, than to receive subsidies to partially support the creation of new jobs; for the unemployed it is more suitable the coupling of the unemployment aid with their availability to work. At the same time, the salary must be consistent with the employees' efforts, skills and professionalism in order to support work and hence labour productivity.

In order to restore labour market conditions and to reduce unemployment, NMS governments have implemented and will continue to implement training and reintegration programs on the labour market, with the support of European funds. For that purpose, municipalities proposed accelerating public works in an attempt to attract a part of the labour force dismissed due to the crisis.

Despite the labour market reforms and the progress made on activation policies that link social assistance recipients with the activity of actually looking for a job, the employment rates in the NMS, except the Czech Republic, are well below the EU 27 average, and far from the target required by the strategy of "Europe 2020" (of 75%).

The NMS took a series of measures to support labour market reforms in order to improve internal and external competitiveness of their economies, but this was made with extremely high social costs, as wages, pensions and social benefits cuts. The stubbornly high or still growing unemployment, the negative economic growth, the large fiscal imbalances, the dependence on external financing, the tensions and imbalances in the banking system make from NMS the place of manifestation of major challenges for public policy management.

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