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**Research Report**

## True and false remedies for long time unemployment in Visegrad countries

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# CASE Network Studies & Analyses

True and false remedies  
for long term unemployment  
in Visegrad countries

Ágota Scharle

No. 475/2014

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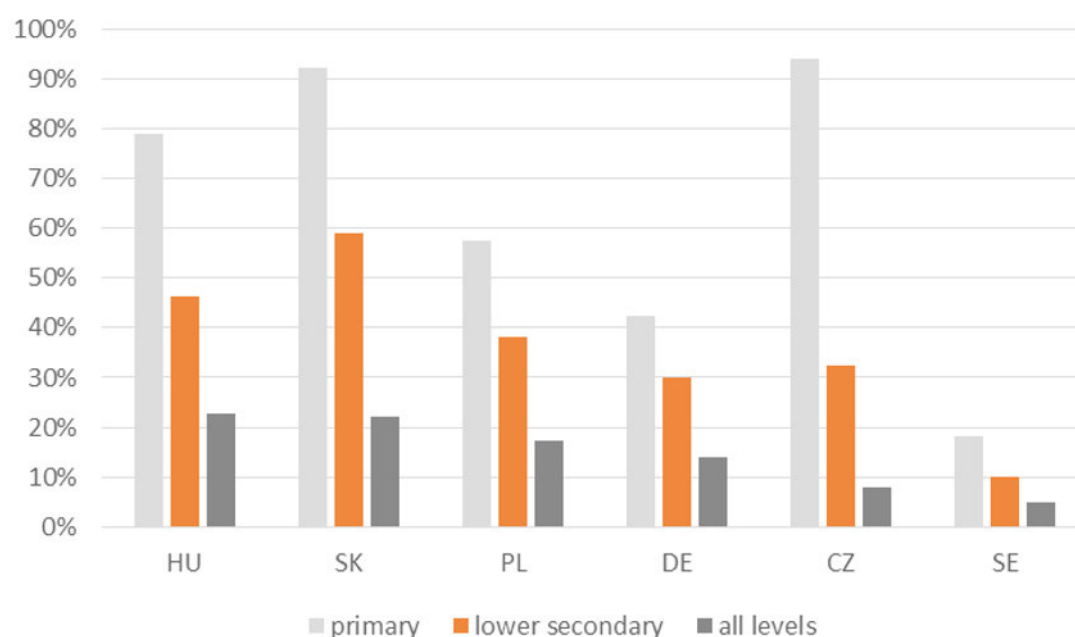
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## 1. Long term unemployment is very high among the uneducated

Two in ten working age adults have been out of work for over a year in Visegrad economies<sup>1</sup> and long term joblessness is especially high among the uneducated. The employment disadvantage of uneducated workers tends to be larger than in Western European countries, and is especially grievous in Hungary, where a relatively large share of the labour force has only completed primary school. The build-up of long term joblessness may take its toll both on the individual and the economy. Beside the loss of human capital and potentially harmful effects on health and mental health, the lower job search intensity of the long term unemployed may lead to weaker wage adjustment and slower economic recovery (OECD, 2011). Long term non-employment also increases poverty and social exclusion, which may further constrain economic growth (Easterly et al 2006).

**Figure 1. Share of long term non-employed by level of education in 2012**



Source: Own calculations using the EU Labour Force Survey for 2012. Notes: Population aged 15-59. Share of population inactive or unemployed (excluding full time students) at the time of the survey and also in the previous year. Primary includes ISCED levels 0 and 1, lower secondary includes ISCED levels 2 and 3c (less than 2 years). Germany (DE) and Sweden (SE) are also included for reference.

<sup>1</sup> The precise number is 1.7, including inactive persons as well. Own calculations using EU Labour Force Survey (LFS) for age 15-59, year 2012.



Reducing long term unemployment by activating the unemployed, increasing the education level or preventing early retirement could potentially increase the total employment rate by 2-3% points in the Visegrad countries<sup>2</sup>.

## 2. Causes of long term unemployment

Unemployment has risen in all EU Member States during the recent global crisis, however, the extent to which these shocks translated into persistent unemployment has varied considerably. In Eastern Europe, the problem has much deeper roots, which cannot be changed but are nevertheless important to understand. The transition to market economy led to a sharp drop in labour demand and especially in the demand for unskilled labour. The policy response varied across the region: some governments sought to alleviate the social impact of the initial shock by slowing down the privatisation process, others provided early pensions to the unemployed or wage subsidies for firms that employ low productivity workers. Balla et al (2008) show that a combination of fast privatisation with high wage subsidies (and low pensions/benefits) was the best to achieve low inequalities and high aggregate employment. Hungary chose the worst combination of fast privatisation with high benefits leading to persistently low employment, while the other Visegrad countries went for the second best option of slow privatisation.

The gap between skilled and unskilled employment rates however has remained large and persistent throughout the region, which suggests that technological change played a more important role than welfare policies or indeed, any policy concerning low wage employment, including taxation or minimum wage setting.

This is not to say that policies have no impact: well designed and coordinated employment, economic and education policy can at least reduce the problem<sup>3</sup>. Strengthening the public employment service so that they can effectively monitor job search and tightening access to early pensions and disability pensions can keep more people in the active labour force and help contain welfare spending. A cautious minimum wage policy, wage subsidies targeted to the low skilled, a stable business environment and a low administrative burden on SMEs can all help to encourage labour demand for the unskilled. Improving teaching methods in public education would help by reducing the share of the low skilled

<sup>2</sup> A simple simulation based on a decomposition of differences in country level employment rates shows that the Czech employment would be 1% point higher if the employment probability of people aged 15-24 and 55-64 was similar to the Slovak case. The Hungarian employment rate would be 2.5 % points higher if the share of the low educated was as small as in the Czech Republic (own calculations using EU LFS for 2012).

<sup>3</sup> These policies have proved effective in developed market economies, and there is some evidence of their effectiveness in the Visegrad countries as well (see Table 2).



in the future labour force while training and retraining have a similar impact on the current labour force.

### **3. Government response has been dominated by benefit cuts**

The government response to persistent long term unemployment and growing welfare costs seems to have been rather similar across Visegrad countries. In the 1990s, they made repeated cuts in the amount, duration or the coverage (i.e. in the rules of eligibility) of unemployment benefits. These cuts helped reduce welfare spending, but they had little or no effect on labour supply while considerably increased poverty (Klugman et al 2002). Efforts to tighten access to early pension and disability schemes were more effective in raising labour supply but these measures have only been made towards the late 1990s.

Minimum wage rises in the late 1990s or early 2000s also aimed to increase labour supply, with modest or even negative effects on employment, where the response of labour demand proved stronger than expected<sup>4</sup>. Incentives to boost labour demand were introduced only in the early 2000s, and were rarely targeted to the low skilled<sup>5</sup>. Measures to improve the quality and access to public education and employment rehabilitation services or to tighten the job search requirements of welfare benefits have been applied at times, but rarely with a sustained effort that could yield a lasting impact on labour market exclusion<sup>6</sup>. None of the four countries have developed and implemented a sophisticated profiling tool that would help the job centres to identify job seekers with a high risk of becoming long term unemployed (Maksim and Sliwicki, 2012, Mýtna Kureková 2014).

In the past ten years two diverging strategies have emerged. Czech and Polish governments have sought to solve the problem by relegating the responsibility for dealing with long term unemployment to the regional level and giving more autonomy to regional units of the employment service. By contrast, Hungary and Slovakia have increasingly relied on centrally subsidised public works. Neither of the two strategies have brought much success.

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<sup>4</sup> This was the case in Hungary where the doubling of the minimum wage reduced low skilled employment by about 3%, the effect being larger for small businesses, youth and in disadvantaged regions (Kertesi and Köllő 2003).

<sup>5</sup> Exceptions are the tax subsidies for the long term unemployed in Hungary (2007-2012) and Slovakia (2014), preferential tax rates (Czech Republic, Hungary until 1995) and tax cuts (Slovakia 1999-2000) for SMEs. See more detail in Table A1 in the Appendix.

<sup>6</sup> Notable exceptions are the Polish (from 1999) and Hungarian (between 2003-2010) education reforms, and the Slovak reform of the welfare system and ALMP (active labour market policies) (2003-2004).

**Table 1. Participants and spending on Public Works Programmes and PES staff in 2012**

	Poland	Czech Republic	Slovakia	Hungary
<b>Average number of participants</b>	24 702	6 669	54 968	63 023
<b>% of registered unemployed</b>	1.1	1.3	13.2	21.4
<b>Government spending million EUR</b>	40.4	27.4	51.1	455.3
<b>% of GDP</b>	0.01	0.02	0.07	0.47
<b>Spending on PES staff, % of GDP</b>	0.08	0.11	0.07	0.12

Sources: Eurostat online, Mýtina Kureková et al (2013:27); MPIPS (2012), Scharle (2014).

Notes: The figures for Poland include public works and socially useful work

Slovak figures as of December 2012, PES= public employment service.

In Poland, successive reforms in 1993, 2000 and 2002 created a highly decentralised system in which the 16 regional labour market offices (Wojewódzki Urząd Pracy) allocate central government funding among the local job centres according to their own regional strategies and are also responsible for staff training at local (powiat level) job centres (Starega-Piasek et al 2006). In the Czech Republic regional autonomy was introduced in 2011, with the establishment of 14 regional labour market offices that are responsible for designing and implementing labour market programmes financed by the line ministry. This was expected to improve cooperation with labour market stakeholders at the regional level. However, both the Czech and the Polish system lack a strong financial or bureaucratic incentive for regions to improve the efficiency of employment policy: the main source of funding comes from the central government and does not depend on performance indicators. A further constraint is that the regionalisation process has not entailed a systematic development of local expertise in labour market analysis and programme design, which would be a precondition for reaping the benefits of regionalisation (Mosley 2013).

Hungary and Slovakia both established a large public works scheme that employs on average 15-20% of the long term unemployed population. Public works programmes are admittedly not able to reduce long term unemployment, but provide temporary relief to jobless households and may also help reduce social tensions at the local level (Köllő and Scharle 2012, Mýtina Kurekova et al 2013). When used on a large scale however, they are not only ineffective but may even aggravate the problem (Harvan 2011). Both the Hungarian and Slovak schemes are prone to this risk, due to some perverse incentives in their administrative setup<sup>7</sup>.

<sup>7</sup> The main features of public works systems in the region are summarised in Table A2 in the Appendix.



First, the inefficiency may arise from lock-in: when jobseekers can expect to be recalled on public works, some may tend to make less effort to look for a job in the open labour market<sup>8</sup>. Second, the per capita cost of public works is always higher than the cost of cash benefits to the poor: managers, tools and materials must also be paid, not to mention corruption<sup>9</sup>. Given the tight budget for employment policies, this implies that less resources are available for the potentially more effective programmes, such as retraining.

Perverse incentives are especially strong in the Hungarian case, where public workers are removed from the unemployment register and get their wage directly from the local government, who are reimbursed from the central budget, with little supervision on how they use these funds. This implies that local governments have a strong interest in managing public works, which has led to an escalation of the costs and created a political straightjacket for the central government. Any attempt by the central government to cut spending on public works is likely to be met by a strong opposition from mayors, and will attract bad publicity as well, since a mass layoff of public workers will immediately increase registered unemployment.

#### **4. There is room for improvement in policy making**

Post-socialist economies inherited a public administration skilled in planning rather than designing sophisticated incentives for independent actors in a competitive economy. Government institutions were reorganised in the 1990s and most Visegrad countries have made further adjustments to increase bureaucratic efficiency, especially around the EU accession. However, government decision making procedures do not yet (or at least not systematically) follow the best practice of Scandinavian or British governments where policy makers rely on monitoring results and impact evaluation of past measures, often delivered by independent experts (Meyer-Sahling 2009, Verheijen 2006). The procedures for consulting government experts across ministries, social partners and other stakeholders also tend to be weak, making it difficult to implement complicated reforms, especially in the areas where potential gains can be reaped only in the long run (Sirovatka 2008, Váradi 2012).

The political constraints to implementing reforms tend to be especially strong in the policies that affect long term unemployment. First, such policies typically require

<sup>8</sup> If public works jobs are full time, this further reduces job search activities as participants have less time to look for a regular job. This effect is obviously more significant where there are job vacancies in the area.

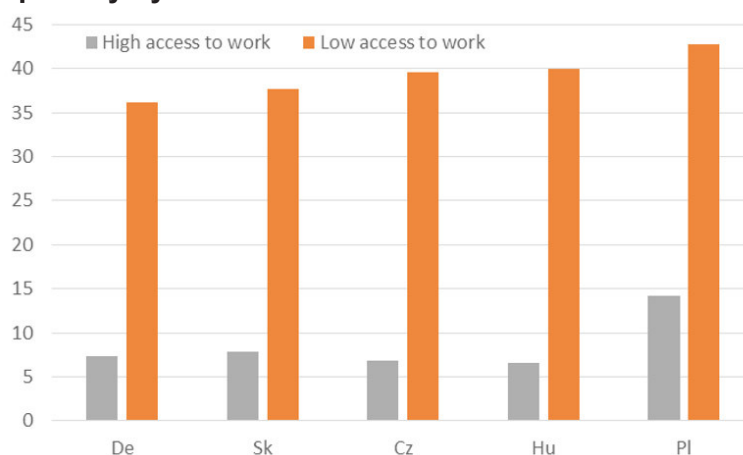
<sup>9</sup> This is less of a concern in the Slovak case where public workers are not paid wages, only a supplement to their benefits and organisational costs are usually financed by the municipalities.

complex deals with stake-holders, careful design, and thorough implementation and monitoring (Bonoli 2010). Second, some of the necessary measures, such as further cuts in early pensions or public education reform would also hurt the middle class (the median voter). Lastly, governments face a temptation to play on the strong anti-unemployed prejudice of middle class voters and use disadvantaged groups as a scapegoat for the recession, or more generally, for the slower-than-expected convergence to EU15 standards of living and all the unexpected and unpleasant social consequences of the transition. A large Roma minority tends to increase this temptation, and very likely have contributed to the expansion of public works programmes in Hungary and Slovakia.

## 5. Why should we still keep trying?

Long term unemployment leads to poverty and when it affects large groups, it can fuel social unrest and exclusion, with harmful consequences on society and economic growth as well. This is because the lack of social cohesion tends to weaken political and economic institutions (broadly defined to include trust and cooperation as well), and that has been shown to slow down economic growth (Easterly et al 2006). Hence, governments cannot afford to overlook the problem of long-term unemployment nor can they hope that economic growth alone would solve it. However, if governments can make some progress in implementing effective measures and increase the employment rate of unskilled workers, this will have the added benefit of easing social tensions and a decline in prejudiced attitudes against the Roma.

**Figure 2. Risk of poverty by level of access to work in the household in 2012**



Source: EU SILC, Eurostat.

Note: In households with low access to work (low work intensity) adults aged below 60 worked less than 20% of their total work potential during the past year. High work intensity implies working 55%-85% of the total work potential. Germany (De) is included for reference.



## 6. What can be done?

There are no quick wins in employment policy. Effective policies (listed in Table 2) are either complicated to implement, or bring slow results, or go against public attitudes, or all of these. It is also important that most measures work best in combination: for example, targeted wage subsidies to increase demand for the unskilled bring better results if supported by tightened job search conditions for the long term unemployed that increase labour supply. Many of the measures would require an initial investment in the public employment service and the broader context of public administration in order to improve the quality of policy design and implementation. This requires considerable political commitment as there are no short term gains, though returns are high in the long run.

Though the task may seem daunting, all of the Visegrad countries have made progress in implementing some of these policies, and each have some successful practice to share.

The Polish reform of secondary education was a major step towards preventing long term unemployment by improving the literacy and numeracy skills of school-leavers, including those who come from a disadvantaged background (BI 2014).

Hungary introduced a carefully designed wage subsidy, which was targeted at the long term unemployed with primary education or aged over 50. The subsidy was available to all jobseekers meeting these simple criteria and was administered by the tax authority, who had to issue the voucher without considering any other personal characteristics. This ruled out any chance of corruption or cream skimming (selection of favoured candidates) by the job centre, which often mars the effectiveness of traditional wage subsidy programmes. A recent evaluation found that the subsidy significantly increased the reemployment chances of long term unemployed men aged over 50 (Cseres-Gergely et al 2013). If targeted narrowly at the long term unemployed with multiple disadvantages, such subsidies can be cost-effective and are much cheaper than across-the-board cuts in social security contributions.

The job search conditions of unemployment or other benefits have been tightened in all the four countries, but the most comprehensive reform was implemented in Slovakia in 2004 (Kalužná 2008). The reform formally merged employment services and social services to create “one-stop shops” for the unemployed and social assistance beneficiaries. PES staff was increased and some of the administration reallocated, which reduced the workload of professional counsellors to more manageable levels by 2006. Unemployment benefit receipt was made conditional on providing a proof of active job search and visiting the local



job centre every two weeks (every week for long term unemployed). At the same time job centres were obliged to draw up an Individual Action Plan for disadvantaged jobseekers and hire employer specialists who proactively look for job vacancies. Several institutional and procedural improvements were however not fully implemented and were revoked in the May 2013 reform of the Employment Services Act (Duell and Mýtina Kureková 2013).

The Czech Republic established a network of agencies for social inclusion in Roma localities to coordinate integration policies at the local level (MHR 2009). Agencies assess local needs in education, housing, social services and employment, establish partnerships and provide training, supervision and in some cases funding for existing local service providers to be able to effectively meet these needs. The long term unemployed often struggle with multiple problems that create barriers to reemployment. By resolving indebtedness, poor housing, family breakdown, addiction, etc, such agencies can support the efforts of public employment services to activate hard-to-place jobseekers. Their work is especially useful in villages where the municipality does not have the resources or expertise to provide effective services to the long term unemployed.

The devil is in the detail. The effectiveness of these and other measures for the long term unemployed crucially depends on appropriate design and implementation. Getting these right requires thorough and regular monitoring, piloting of new measures and adjustments, preferably in randomised trials and impact evaluation based on a comparison of participants and an appropriate control group. Given the similarities of the economic and institutional context, Visegrad countries could also benefit from sharing and discussing the results of such policy evaluations.



**Table 2. Possible measures to reduce long term unemployment by degree of feasibility**

+ feasible; - constrained; o varies depending on design and context

	Inexpensive* or even brings savings	Quick returns	Not against public attitudes	Does not need competent PES	Low risk of corruption/ deadweight	Simple to design	Will work on its own as well	Supporting evidence
Targeted wage subsidies	+	+	+	+	o	o	o	Hu1
Tighten job search conditions, expand/ train PES staff for casework with LTU	+	+	+	o	+	o	o	Sk1 Hu2
Job trials and transit programmes	+	+	o	-	o	+	-	Hu3
Reduce access to early pensions/disability and improve rehabilitation	+	+	-	-	o	o	o	Int1
Reduce admin burden on SMEs	+	-	+	+	+	-	+	Int2
(Targeted) cut in the minimum wage	o	o	-	+	+	+	+	Int3
Retraining, second chance literacy training, life-long learning	o	o	+	-	-	-	-	Hu4
Strengthen the services of social work agencies and their links with the PES Strengthen the services of social work agencies and their links with the PES	o	-	+	-	+	-	+	Cz1
Long term complex local development programmes	o	-	o	+	+	-	+	Int4

Sources: Cz1: DIC 2012, Hu1: Cseres-Gergely et al 2013, Hu2: Cseres-Gergely 2012, Hu3: Györgyi and Mártonfi 2002, Hu4: Adamecz et al 2013, Int1: Marie and Vall Castello 2012, OECD 2010, Int2: Yakovlev és Zhuravskaya 2007, Int3: Neumark and Wascher 2008, Int4: OECD 2013, Sk1: Csillag et al 2013. See also recommendations in World Bank 2008, 2012.

Notes: \* Initial costs are low compared to the other measures, not only comparing across active labour market programmes (ALMP). LTU= long term unemployment, SME=small and medium size enterprises, PES=public employment service.

## Appendix

**Table A1. Policy measures affecting long term unemployment in Visegrad countries**

	Czech Republic	Hungary	Poland	Slovakia
<b>Supply side incentives to reduce excess supply e.g. via early pensions and disability pensions</b>	1989-1998	1989-1995	1989-1998	1989-1998
<b>Supply side financial incentives: cutting level or access to benefits or increasing in-work income* to increase labour supply</b>	1992-1996 (UI, SA) 1998-2003 (min wage) 2002 (UI, early pension) 2006 (Increase in ceiling of bottom PIT bracket) 2007 (SA) 2008 (UI, flat rate PIT) 2010 (UI, early retirement)	1992-2002 (UI, UA) 2001-02 (min wage) 2008 (disability) 2011 (UI, UA, disability, early pensions)	1996 (UI) 1997-1998 (min wage) 2001 (early pension) 2002 (UI) 2004 (early pension) 2005 (disability) 2008 (early pension, min wage) 2011 (disability) 2012 (min wage)	1992-1998 (UI) 2000 (UI) 2002-2004 (UI, UA) 2000-2004 (min wage) 2007 (UI)
<b>Supply side behavioural incentives: tightening behavioural conditions</b>	2004 (UI) 2007 (SA) 2013 (UI,UA)	2005 (UI) 2008 (disability) 2009 (UA) 2011 (UA)**	1996 (UI) 2002 (UI) 2005 (UI, UA) 2009 (UI)	1998 (sanctions upon voluntary quit) 2003-2004 (UI, UA)
<b>Demand side incentives for market employment (SSC, wage costs, SME admin costs)</b>	2004-2006 (series of general CIT cuts)*** 2006 (ease in business registration) 2009 (general cut in SSC) 2009 - 2010 (series of general CIT cuts)	2007 (targeted cut in SSC) 2009 (general cut in SSC)	1999 decreased taxes for individual entrepreneurs 2002 (EPL reform: increased flexibility for small businesses) 2004 general CIT cut	2004 CIT cuts
<b>Demand side spending on public employment***</b>	-	2009 public works 2013 public works	1992-3 public works	1990s public works 2004 public works
<b>Improving services</b>	2009 IAP 2012 Regionalisation of PES	1993-1994 network of social workers 2003 education reform	1993-2002 regionalisation of PES 1998 ALMP for fresh graduates 1999 education reform 2004 standardisation of PES services 2006 IAP, enhanced activation for LTU 2009 IAP	2002 IAP 2005 ALMP effectiveness monitoring 2012 ALMP assessment

Notes: ALMP= active labour market programmes, CIT=corporate income tax, EPL= employment protection legislation, IAP= Individual Action Plans. LTU=long term unemployed, PIT=personal income tax, SA= recipients of (means tested) social assistance, SSC= social security contributions, UI= insured unemployed, UA= jobseekers receiving unemployment assistance (after exhausting insured unemployment benefit).



\* In a few cases governments made an effort to reduce poverty by improving access to social transfers or increasing their amount (for example in Hungary in 2005-2006). These are not included in the above table.

\*\* The behavioural conditions included potentially highly stigmatising elements as well, such as keeping a tidy house and were left to the discretion of local governments.

\*\*\* We use a single term 'public works' to refer to all the different types and variants of public employment especially created for unemployed persons (but excluding subsidies for the private or non-profit sector).

**Table A2. Design of public works programmes in 2013**

Programme	Hungary	Slovakia	Czech Republic	Poland
<b>Explicit aims</b>	Activate the unemployed, prevent losing contact with the labour market, prevent loss of work habits, provide temporary relief to alleviate poverty			
<b>Latent aims</b>	Appease population that social assistance recipients, many of whom are Roma, have to work in order to receive support.		None.	Increase employment rate, cut spending on social benefits
		Discourage black work		
<b>Who can participate?</b>	All registered unemployed, also rehabilitation allowance recipients	Only minimum income benefit recipients	Targeted at hard to place groups, including disabled jobseekers	PW: LTU, and other disadvantaged unemployed SUW: unemployed ineligible for social benefit
<b>Do participants stay on the unemployment register?</b>	No	Yes	No	No
<b>Working time per week</b>	20-40 hours	10-20 hours (or more since January 2014)	Part-time	PW: no regulation SUW: max 10 hours
<b>Maximum duration (months)</b>	11	18, renewal after 6 months (for municipal contracts)	12 (renewable)	PW: 12 SUW: 48
<b>compensation of public workers</b>	Wage	Higher benefit (activation allowance)	Wage	Wage
<b>Is it insured? *</b>	Fully (P, H, A, U)	Partly (H)*	Fully (P, H, A, U)	Partly (P, H, U)
<b>Who pays the compensation of workers?</b>	Central government reimburses employer via PES (up to 100% of wage costs)	Central government pays the higher benefit via PES	Central government via PES	PW: 50% local government SUW: partly local government
<b>Who pays the other costs (organisation, materials, etc)</b>	<b>Employer but managers can be public workers, subsidies are available for other costs</b>	<b>Organiser**</b>	<b>Employer</b>	<b>Employer</b>
<b>Supervision of use of government subsidy</b>	Very weak	Weak	Weak	Weak (Poorly -designed performance indicators)

Notes: \*Participants are covered by pension (P), health (H), accidents (A) and unemployment (U) as well. Unemployment insurance would imply that they can earn eligibility for insured unemployment benefit after a certain period of public works. In the Slovak case the entitlement for health insurance is based on registered unemployed status not on participation in public works. LTU= long term unemployed, PW= public works, SUW=socially useful work. \*\* In most cases this is the local government, but can also be the PES, in which case other costs are covered by the central budget.

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