Brief: New Member Countries’ Labour Markets during the Crisis

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The present contribution is devoted to labour markets in New Member Countries, in particular the EU-10, during the crisis. The focus is on the most recent evolution of unemployment and its constituting elements: flows into and out of unemployment. The main findings, based on recent quarterly and monthly data, may be summarized as follows:

1. Registered unemployment is considerably higher than before the crisis and it is still rising. However, in most countries the unemployment rate is not yet at the maximum levels reached earlier in the 2000s and will not be approaching these maxima in the near future.

2. The response of the labour markets to the crisis has been more complex than in the past downturns: a significant part of the adjustment has come in the form of a shorter workweek. As a result, employment has contracted less than aggregate economic activity but underemployment has risen.

3. Adjustment in the form of shorter workweeks and/or underemployment may be temporary and can evolve into increase in open unemployment.

4. The greatest increase in EU-10 registered unemployment occurred around the first quarter of 2009. Data on inflow and outflow into unemployment suggest subsequent stabilization which, however, may be temporary.

5. The structure of employment is also changing in that we observe a higher share of shortterm contracts and increased regional labor mobility. The share of long-term unemployment has dropped temporarily because of the high inflow of the newly unemployed. The crisis has so far not led to a marked increase in economically inactive population.

6. In countries for which August-October 2009 monthly data are available, one observes recent improvements in the functioning of the labour markets in that there is higher labor mobility and greater willingness to accept offered position.

7. The groups that are most negatively affected in the labour market are foreign workers, less educated workers and minorities. The employment rate of university educated people has in fact risen, while that of the less educated has fallen, similarly to the situation in most EU countries. Social exclusion as a result of the crisis is therefore a serious concern.

8. Risks: The greatest risks are (a) a protracted W- or L-shaped economic recovery in EU15, (b) rising long-term un(der)employment accompanied by hysteresis, and (c) fiscal imbalances brought about by (a) and (b) above.

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1. Economic environment in the new member countries

EU-10 were affected by the financial crisis later than the older EU members and the effect came through somewhat different channels. In particular, the financial institutions of EU-10 mostly avoided the first stage of the crisis because of their low exposure to U.S. toxic assets. Yet, the countries could not avoid a dramatic drop in the demand for their exports and the contractionary effects of frozen international capital markets. The negative export effects have been particularly strong because EU-10 are very open to trade. Hence, the high export orientation that helped these economies achieve above average growth rates before the crisis has contributed to the severe downturn during the crisis. Although this negative effect influenced all the EU-10, the resulting changes in economic activity were differentiated – countries with worse initial macroeconomic situation (fiscal imbalances), higher shares of foreign currency denominated debt, and inflexible exchange rate regimes were more vulnerable and had more limited options in mitigating the effects of the crisis. As a result, while the Baltic countries have been among the worst hit, other countries, such as Slovenia, Poland, and Czech Republic, have experienced a milder increase in unemployment.

2. Changes in employment and unemployment

The economic downturn has led to a reversal of the gradual decrease in unemployment that most of the EU-10 countries had been experiencing before the beginning of the crisis. Given the dependence of EU-10 on demand within EU15, with the exception of Hungary the rise in unemployment came slightly later in EU-10 than in the EU 15 countries (see Figure 4 and Figure 5). Since unemployment is a lagging indicator, within each country its rise has also followed by several months the fall in output.

Figure 4 – Monthly data on total unemployment (Eurostat, seas. adjusted)
Judging from the unemployment rates alone, the situation in the new Member States (other than the Baltic countries) is serious but not yet critical. Indeed, half of the countries have lower unemployment rates than the EU 15 average, and with the exception of Hungary and Latvia, they have lower unemployment than they had earlier in this decade (see Figures 4, 5 and 6).

Figure 5 – Monthly data on total unemployment (Eurostat, seas. adjusted)

Figure 6 - Current unemployment versus maximum between 1st quarter of 2000 and 4th quarter of 2008 (* data for 2000q2). Eurostat NSA data
There are two other factors that have so far mitigated the increase in official unemployment: (i) an adjustment in the form of greater reliance on shorter working hours and (ii) a greater role of migrant (foreign) workers and unofficial (informal) employment. As may be seen from Figure 7, the average number of hours worked per week has declined in all the EU-10 except Latvia and Hungary, with the decline being most pronounced in Estonia, Slovakia and Slovenia. In most of these economies, underemployment has thus become a problem that exacerbates that of measured unemployment. Migrant (foreign) workers employed in low skilled jobs have been among the first to be laid off and in a number of countries they are not counted among the unemployed even if they stay (often illegally) in the host country; in some cases they report themselves as entrepreneurs rather than unemployed. Together with some of the domestic unemployed workers, they join the informal sector, evade paying taxes and some lack social protection.

Finally, with the exception of Poland, all EU-10 have witnessed a rise in the use of part-time employment contracts (see Figure 8). While providing greater flexibility to firms and enabling more of them to survive, this shift tends to reduce the job security and hence welfare of workers. This trend is also related to existing inflexibilities of the labour markets – in the presence of firing restrictions and unpredictable demand, many firms can prefer to hire new workers on temporary rather than permanent contracts.
3. Future developments: risks and opportunities

The main factor that will determine the level of unemployment and other economic indicators in the EU-10 is the speed of economic recovery in EU 15. The response of the EU-10 labour markets to the crisis to date suggests that the unemployment situation will worsen if the EU15 recovery turns out to be very slow.

The danger is a rise in long term unemployment, with its accompanying negative economic, social and psychological effects. Current data suggest that the relative share of long-term unemployment is decreasing, but that is a statistical effect caused by high inflows of newly (and therefore initially short-term) unemployed. In view of the European experience over the last several decades, one also cannot rule out hysteresis in the sense that it will be difficult to bring down a high unemployment rate once it is firmly established and institutions adjust to it.

On the fiscal side, a prolonged period of high unemployment will exert great pressure on the already strained budgets of the EU-10. The Baltic countries rank among the most seriously affected countries and also the countries that may face most serious political risks. They have experienced major tensions related to the situation of the population of Russian origin. High rates of unemployment together with asymmetric impacts of unemployment can increase the risks of political destabilization.

On the positive side, the crisis appears to have increased the mobility of labour. Anecdotic evidence suggests increasing willingness of people to commute and relocate to places with better chances of obtaining work, even in countries with relatively “passive” population (e.g., the Czech Republic). The greater willingness to move is offset, however, by the negative effects of financing constraints on residential investment.
There is also an opportunity to use the crisis as a motivator to reduce excessive regulation that has been hampering efficiency and thus lowering the level of economic activity and consumer optimism.

4. Policy Recommendations

Sensible adjustments in economic policies can lower the risk of a protracted recession and enhance the speed of recovery. In particular:
1. Increasing the flexibility of product and factor markets can help reduce the risk of hysteresis and “jobless recovery”.
2. Adjusting the regulation of immigration and social support may reduce the extent to which foreign workers are “pushed” into black market activities when they lose work.
3. Stimulating intra-EU migration may alleviate the hardship of workers in the most crisisaffected countries, while equalizing EU-wide demand and supply for labor.

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