



European Employment Observatory

EEO Review: Long-term unemployment, 2012

Latvia

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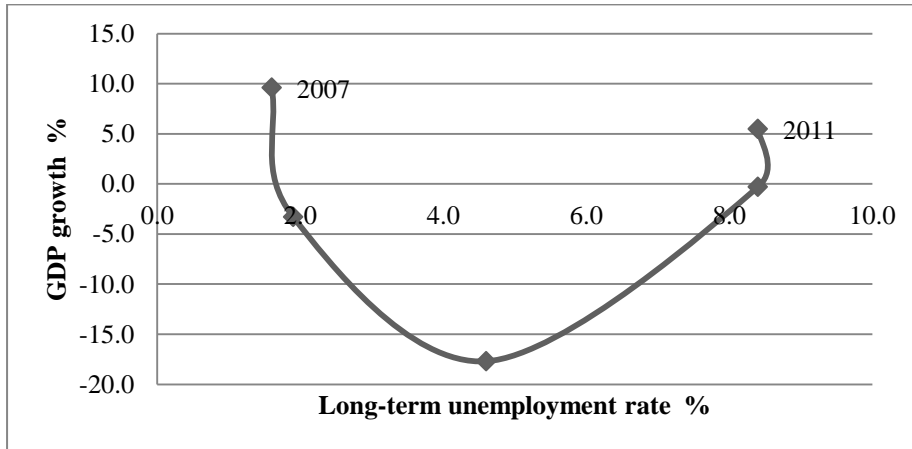
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1. Long-term unemployment trends in Latvia; 2007-2011

Over the last five years Latvia has experienced a particularly severe GDP decline (in 2007-9) followed by strong recovery in 2011. As output collapsed unemployment skyrocketed from 6 % in 2007 to a peak of 18.7 % in 2010¹². In the process, the long-term unemployment rate increased fivefold from 1.6 % in 2007 to 8.4 % in 2010. Despite 5.5 % GDP growth in 2011 and a decline in unemployment to 16.2 %³, the long-term unemployment rate remained static at 8.4 %.

Figure 1: Long-term unemployment vs. GDP growth.



Source: Eurostat

Although all EU countries have experienced rising long-term unemployment over the last five years, the increase in Latvia has far outpaced the general EU trend. Thus, from being well below the EU-27 average in 2007⁴, by 2011 the Latvian long-term unemployment rate was more than double the EU-27 average (see Figure 2).

Moreover, Figure 3 shows that in 2011 the long-term share of overall unemployment was 54.6 % of overall unemployment – more than double as compared with 2007. Alternatively, from having a long-term unemployment share in total unemployment below the EU average, it now stands at nearly 12 percentage points above⁵.

¹ Unemployment rates are for the active population aged 15-74.

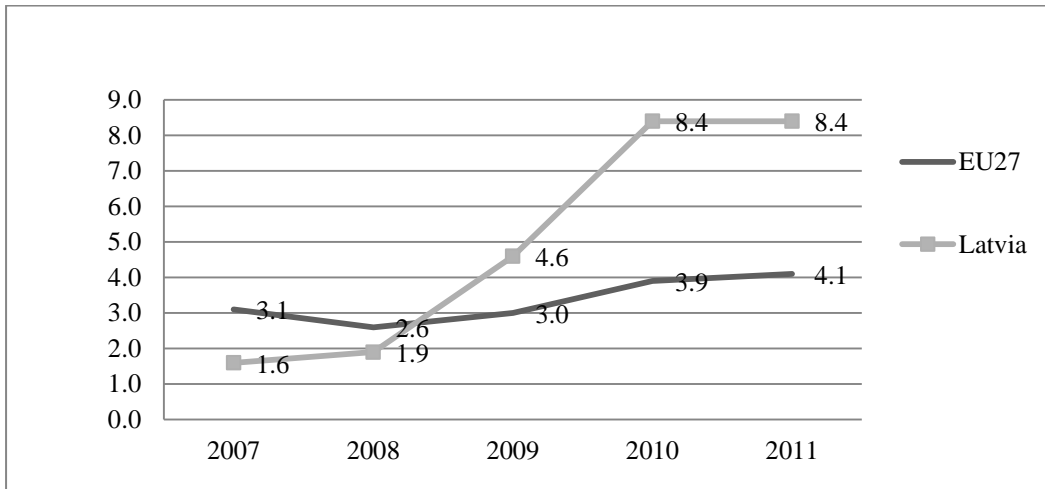
² The quarterly unemployment rate peaked at just 20.2 % in the last quarter of 2009.

³ This represents a figure that has been recalculated using the population data of the 2011 Population Census. The adjustment has the effect of increasing the unemployment rate. Thus for the quarters of 2011 the upward adjustment has been between 1 percentage point and 0.7 of a percentage point and for the year as a whole by 0.8 of a percentage point. Adjusted data for 2010 and before will be available only in 2013.

⁴ It should be borne in mind that 2007 may not represent the best ‘base year’ for comparison. Latvia was at that time the most overheated economy in Europe with an output gap of 14.2 % as compared with 2.8 % for the EU on average (See EU Spring Forecast 2012 Table 13 of the Statistical Annex).

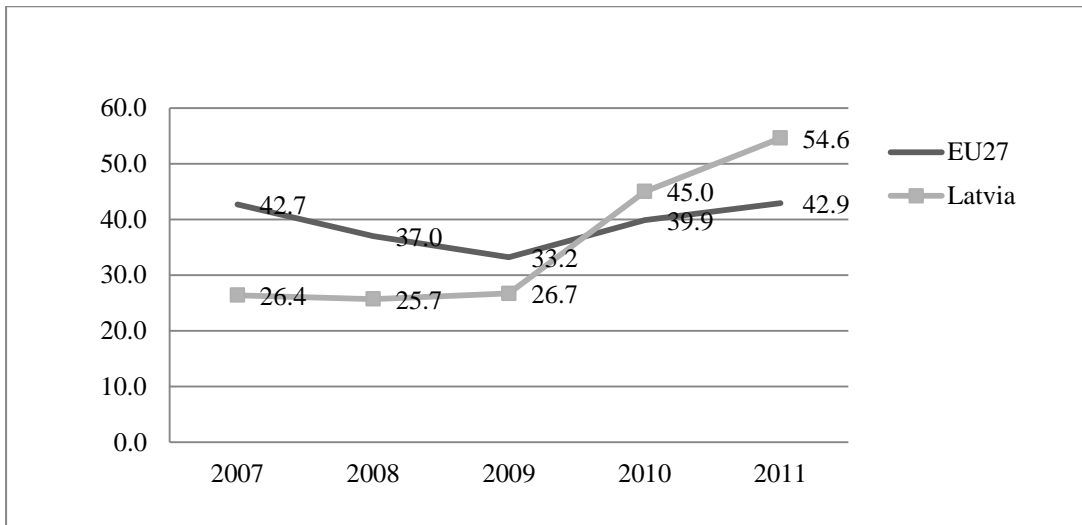
⁵ It should be mentioned that at the same time the absolute number of registered long-term unemployed has fallen. According to the Latvian Central Statistical Bureau in the last quarter of 2011 it was down by 21 300 as compared with the fourth quarter of 2010.

Figure 2: Developments in long-term unemployment (% of age group 15-74)



Source: Eurostat

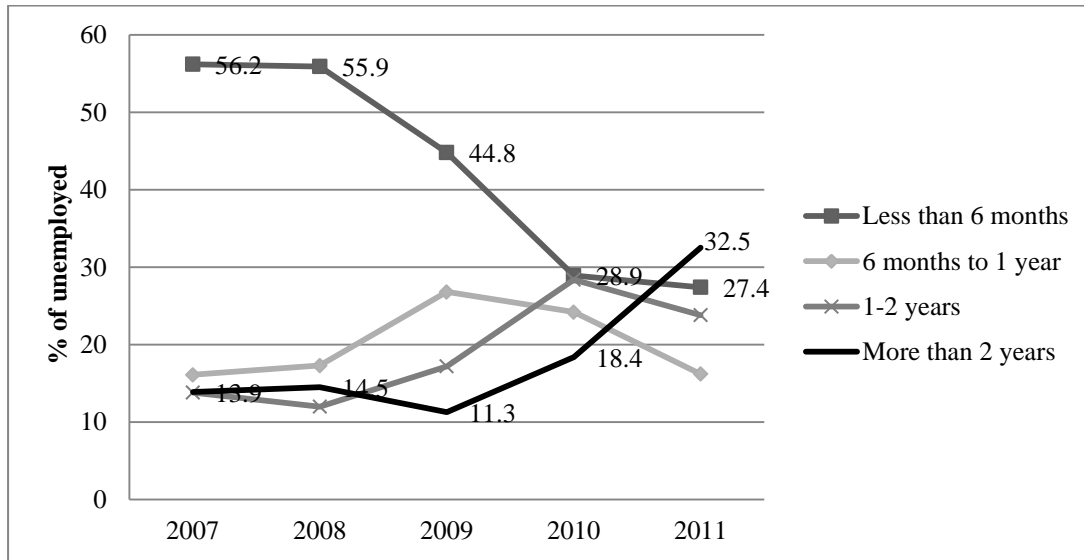
Figure 3: Developments in the share of long-term unemployment (% of total unemployment)



Source: Eurostat

A particular challenge is the increasing duration of unemployment. The duration structure has changed dramatically over the last 5 years with the share of people being out of job for more than 2 years now dominating the unemployment figures with a 32.5 % share of all jobseekers. Moreover, almost half (15.1 % of total unemployed) have been unemployed for more than 4 years (see Figure 4).

Figure 2: Developments in the duration of unemployment.



Source: Central Statistical Bureau of Latvia and own calculations

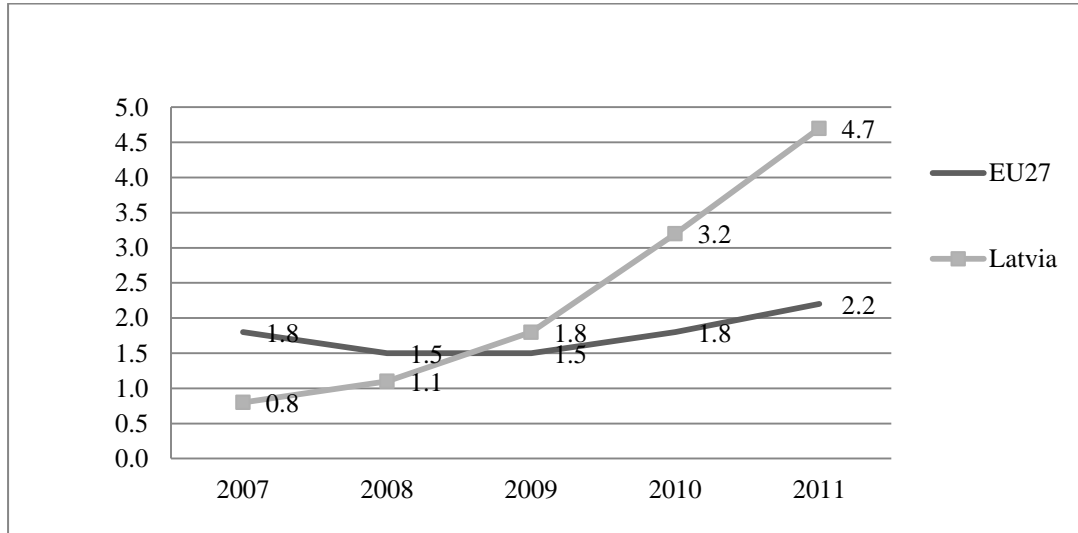
This tendency is also clear from the increase in the rate of very long-term unemployment⁶ (see Figure 5). This indicator has more than quadrupled since 2008 and now stands at 4.7 % of the workforce in Latvia, which is more than double the EU-27 average. In short, the data indicates that there is a group of working age people in Latvia who have persistently not worked for several years.

The share of the long-term unemployed in registered unemployment has also risen sharply: from 18 % in 2007 to 43.7 % in 2011 and it keeps rising, reaching 44.4 % in May 2012 according to State Employment Agency⁷ data. However, changes in legislation, i.e. the requirement from the beginning of 2012 for social assistance recipients to register with the State Employment Agency as unemployed, may have contributed to the most recent increase.

⁶ Defined as being unemployed for two years or more.

⁷ The State Employment Agency (SEA) is the Latvian public employment service.

Figure 5: Developments in very long-term unemployment (% of 15-74 age group)

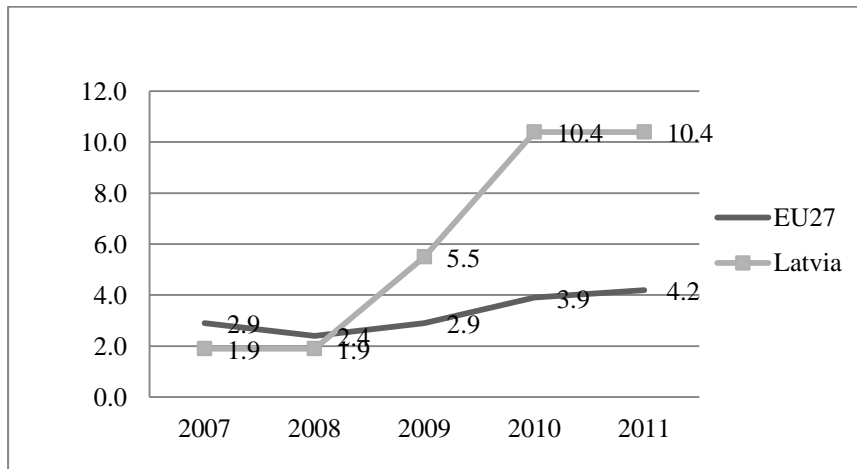


Source: Eurostat

2. Incidence of long-term unemployment across different groups

Long-term unemployment in Latvia is not distributed evenly across different groups. One significant difference in comparison with the EU average, can be observed in the gender dimension. See Figures 6 and 7.

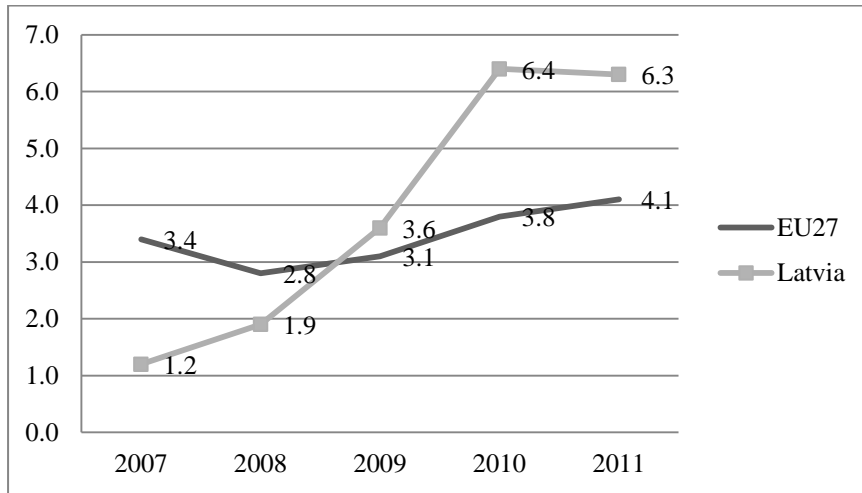
Figure 6: Long-term unemployment rate men (%)



Source: Eurostat

If in the EU -27 in 2011, 4.2 % of men and 4.1 % of women are long-term unemployed, then in Latvia the corresponding numbers are 10.4 % and 6.3 %. This spread between genders has appeared very recently – back in 2008 long-term unemployment among both men and women was at approximately the same level (1.9 % of the active population), which was lower than the EU average of 2.4 % and 2.8 % respectively.

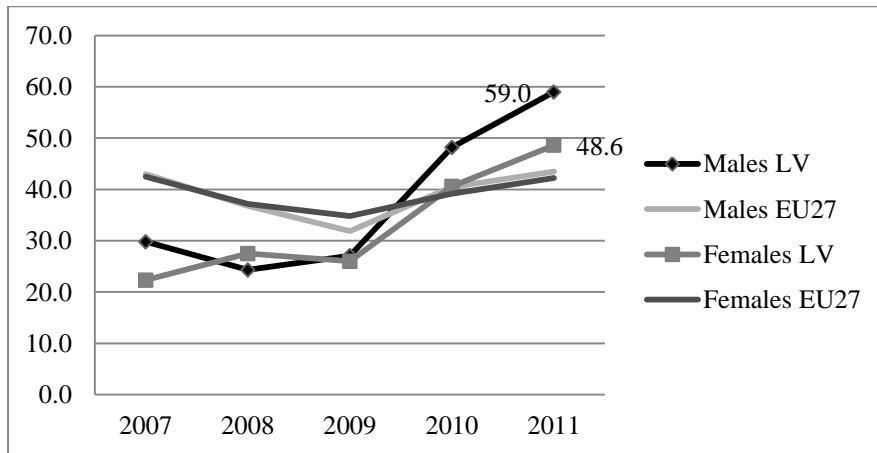
Figure 7: Long-term unemployment rate women (%)



Source: Eurostat

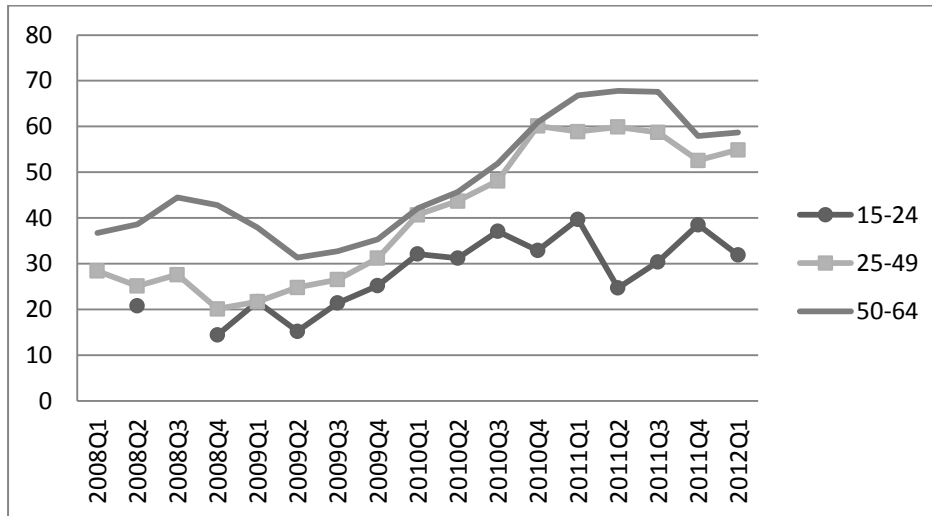
As a result, Figure 8 shows that the share of male long-term unemployed in total unemployment rose from 29.8 % in 2007 to 59 % in 2011, while the share of female long-term unemployed increased from 22.3 % to 48.6 %, with both indicators exceeding EU average levels.

Figure 8: Share of long-term in total unemployment by gender



Source: Eurostat

Another difference appears across age groups. Although an upward trend can be observed for all age groups, the growth rate has not been the same. Between the first quarter of 2008 and the first quarter of 2012, for the 50-64 age group, the share of long-term unemployed in total unemployment increased from 36.7 % to 58.7 % and for 25-49 year-olds the share increased from 28.4 % to 54.9 %.

Figure 9: The share of long-term unemployment by age group

Source: Eurostat

For the 15-24 age group (youth) the share of long-term unemployed increased from 14.4 % in fourth quarter of 2008 to 31.9 % in 2012 (first quarter). Thus, although the incidence of long-term unemployment among young people remains below that of older age groups, the long-term share of youth unemployment has grown fastest.

According to State Employment Agency data, registered long-term unemployed have the following characteristics:

- As of the end of 2011, 15.1 % of all registered long-term unemployed are in the pre-pension age group (age 57-62).
- Women account for 61 % of registered long-term unemployed (which is different from LFS long-term unemployment results).
- 51.5 % of long-term registered unemployed have secondary or lower levels of education.
- At the end of May 2012, 66 % of the long-term unemployed possessed secondary or professional/vocational education.
- Most of the long-term unemployed are service workers (i.e. shop and market sales workers, drivers, cleaners, guards, as well as people without an occupation or profession).

It was also suggested in communications with the State Employment Agency that many of the long-term unemployed have problems getting a job because of inadequate Latvian language proficiency.

3. Long-term unemployment driving factors

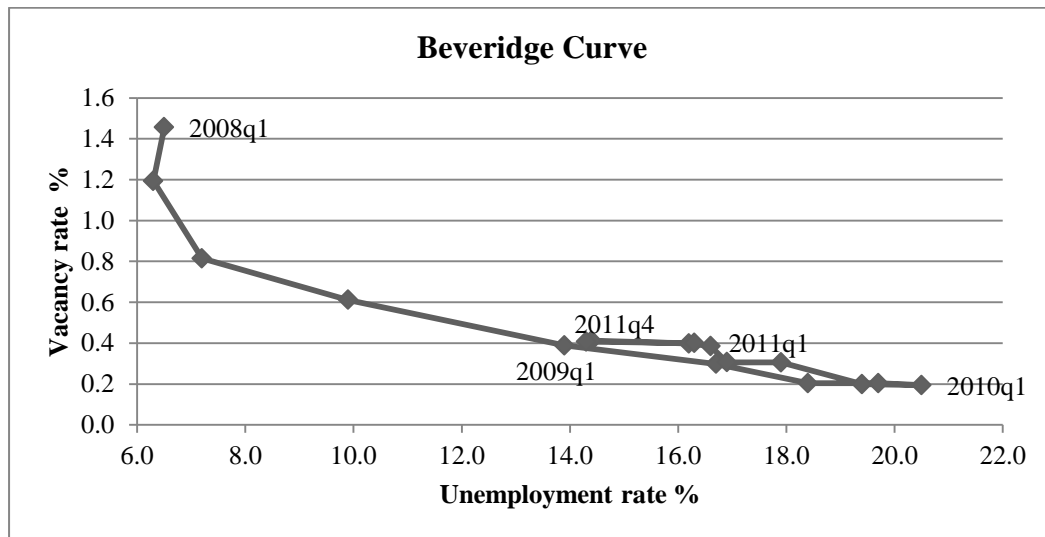
The extent to which unemployment, and hence also long-term unemployment in Latvia represents cyclical as opposed to structural factors, is a debated and somewhat controversial issue. Here, two

analytical approaches are presented: a) Beveridge curve analysis and b) an output gap or NAIRU approach.

The Beveridge curve approach

One approach to evaluating the efficiency of labour market job matching is to examine the relationship between the unemployment rate and the availability of vacancies, the so-called Beveridge curve. The vacancy rate⁸ and the unemployment rate are expected to be negatively correlated in a well-behaved labour market: an increase in the vacancy rate should lead to a reduction in the rate of unemployment (i.e., as vacancies rise in a ‘recovering’ economy, unemployment should decrease). On the other hand, if a vertical segment is observed in this relationship it implies that growing vacancies are not being filled by the unemployed. In other words, there is a ‘mismatch’ between the newly emerging vacancies and the qualifications or skills of the unemployed (i.e. we observe a form of structural unemployment). Figures 10 and 11 show Beveridge curves for Latvia and Figure 12 for the EU-27.

Figure 10: Beveridge curve before Census adjustment

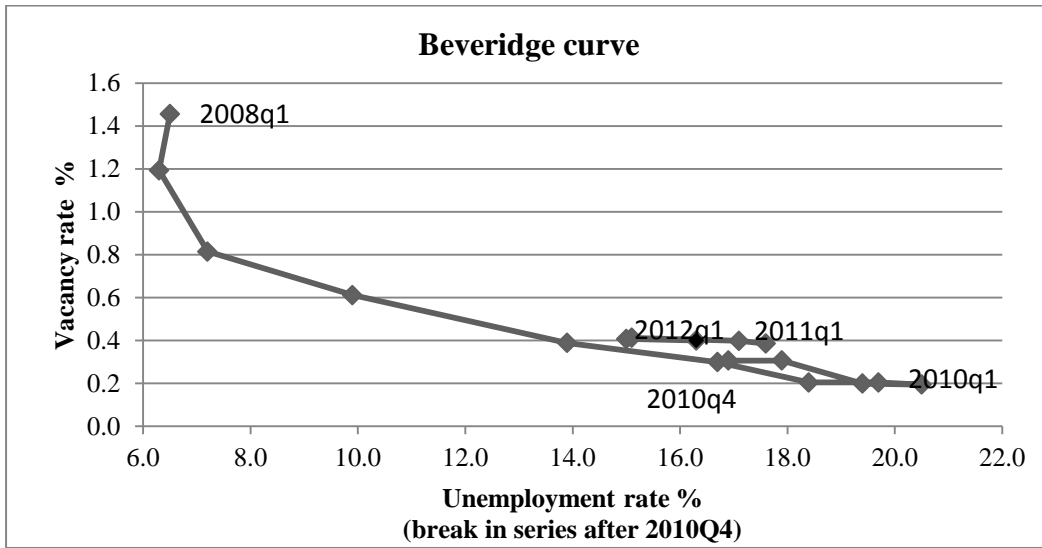


Source: Eurostat

Interpretation of the Latvian situation is complicated by the revisions to the unemployment data currently in process as a result of the 2011 Census. Figure 10 shows the Latvian Beveridge curve using unadjusted data. Clearly the recovery has been accompanied by a movement along the curve (in contrast to the EU-27 as a whole [Figure 12]) and hence the conclusion from the observed Beveridge curve is that the unemployment developments of the last four years have been cyclical.

⁸ The vacancy rate is defined as the ratio of unfilled vacancies to the sum of unfilled vacancies plus the number of jobs filled.

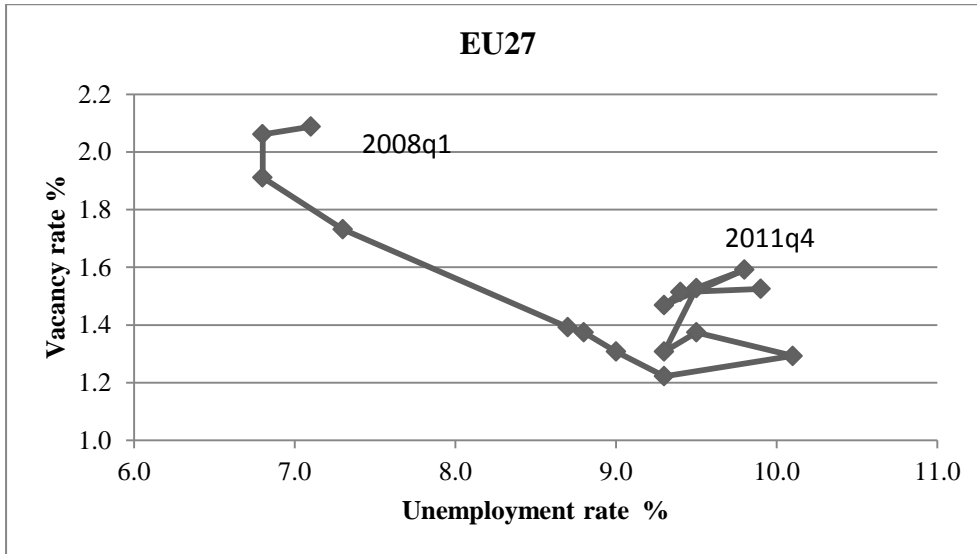
Figure 11: Beveridge curve after Census adjustment



Source: Eurostat and Central Statistical Bureau of Latvia

Figure 11 includes several quarters of adjusted data and there appears to be an outward shift, but this is only because of the adjustment. When all the data eventually is adjusted, the graph of Figure 10 will surely re-emerge as ‘well behaved’ but at a higher level.

Figure 12: Beveridge curve for the EU27



Source: Eurostat

The output gap/ NAIRU approach

An alternative approach to identifying long run structural equilibrium in the labour market is to estimate the unemployment rate at which either the price inflation rate is constant (non-accelerating inflation rate of unemployment or NAIRU) or the unemployment rate at which wage inflation is constant (non-accelerating wage inflation rate of unemployment or NAWRU).

These concepts are closely related to the ‘output gap’⁹. The European Commission estimates these indicators and their calculations of NAIRU and the output gap is presented as part of the 2012 Spring Forecast as shown in Table 1.

The logic of the NAIRU approach is that when actual unemployment is observed to deviate from the NAIRU then the difference represents the cyclical component of unemployment. Similarly, an output gap different from zero represents either overheating or output that is below the sustainable potential of the economy.

Table 1: NAIRU and the gap between actual and equilibrium

	NAIRU (% of Labour Force);	Actual unemployment rate, 15-74, %	Output gap (% deviation from potential output)
2002	12	12	-1.2
2003	11	10.6	-0.3
2004	10	10.4	1.5
2005	10	9	4.4
2006	9	6.8	9.2
2007	10	6	14.2
2008	11	7.5	8.2
2009	12	16.9	-10.3
2010	14	18.7	-9.4
2011	14	16.2*	-4.3
2012	15		-3.1
2013	14		-1.5

*Source: EC 2012 Spring Forecasts * Census adjusted.*

Figures for 2012 and 2013 are Commission forecasts.

It can be seen that, since 2008 actual unemployment has been above the NAIRU and the output gap has been negative. Therefore, the excess of actual unemployment over the NAIRU represents the cyclical part of unemployment. The level of the NAIRU itself represents institutional factors such as labour market legislation or the role of trade unions as well as long- term discrepancies between the skills of the workforce and market demands.

The Latvian NAIRU estimated by the Commission is notably high and rising, suggesting that the structural component of Latvian unemployment is high¹⁰. Arguably, in Latvia there is still a

⁹ The output gap is defined as the deviation in actual output from long run potential output.

¹⁰ Latvia has the highest NAIRU of the former-communist new member states.

Soviet 'legacy' effect with some workers unable to fully adjust to the demands of a market economy and the Commission estimate remains controversial. For example, Zasova (2011) finds that the Latvian NAIRU gradually decreased from the mid-1990s, when it was 11.9 %, to 9.6 % in 2008, but following the 2008 crisis it rose slightly to 9.9 % in the second quarter of 2010, but then declined again and at the end of 2010 was 9.8 %¹¹.

There is a view that the nature of the structural mismatch in Latvia primarily takes the form of a skills mismatch (i.e., labour shortage of skilled workers in almost every sector and profession, and low demand for unskilled ones[see for example Krasnopjorovs, 2012]). A high long-term unemployment rate is important here, because it is well known that the longer people stay out of work, the more they lose skills and employability. Moreover, the long-term unemployed are mostly low-skilled workers with general secondary, vocational or lower levels of education. Thus, long-term unemployment exacerbates the skills divide.

Some part of structural unemployment can also be attributed to shortcomings in regional mobility that has worsened with deteriorating public transport frequencies. The unequal regional distribution of the long-term unemployed suggests this may be a factor. The State Employment Agency data shows that at the end of 2011, the share of registered long-term unemployed was the highest in Latgale (55.7 %) and the lowest in the Riga region (36.1 %). At the same time, Riga had the highest number of vacancies (2 440 out of 3 008 overall in the country) and the highest vacancy rate (0.5 %), whereas in other regions the vacancy rate was only 0.1-0.3 %.

4. Policies to prevent and tackle structural and long-term unemployment

4.1 Active labour market policies

There are no active labour market policies explicitly targeted at the long-term unemployed, but the Government is considering providing incentives to employers for employing the long-term unemployed. A proposal to use tax incentives has been rejected and a wage-subsidy scheme is currently under consideration. The main stumbling block is finding a mechanism to minimise the risk of substitution of regular workers by subsidised workers.

However, the current Temporary Public Works programme (started at the beginning of 2012) and its predecessor the Workplace with Stipend (WWS) Emergency Public Works programme (which was in place from September 2009 until December 2011) are measures that in practice support the long-term unemployed and the potential long-term unemployed. Both programmes aim to create new jobs of social value, such as garbage collection, cleaning road sides, preparing firewood, building small infrastructure in national parks, helping elderly people, etc. Eligibility requires that participants should have been registered unemployed for at least six months and should no longer be eligible for unemployment benefit. Since unemployment benefit lasts for nine months, it seems likely that many participants would be long-term unemployed.

¹¹ With a 95 % confidence interval of 8.1 % - 11.6 %.

The WWS programme is now well known and was presented in a Peer Review of the European Employment Observatory. The Host Country Paper by Mihails Hazans (2012) provides an excellent evaluation of the measure. Hazans shows that:

- More than 72 000 persons benefited from the programme;
- 45 % participated more than once;
- The average total duration of work in the programme per person was about six months;
- 22 % of all the participants were able to find a job six months after their participation;
- The programme helped to retain working skills.

The current Temporary Public Works programme is a slightly modified version of WWS:

- Instead of first come, first served as a selection procedure, the long-term unemployed now have priority in getting placed.
- The duration of work has been reduced from six to four months a year for a given person and two days per month are devoted to training and job search help. The latter changes are expected to contribute to the ability of participants to find a permanent job.

Regional mobility issues have not been previously addressed in active measures. However now, the Ministry of Welfare is planning to initiate a programme that would give grant support to a person who accepts work in a municipality other than where they have been registered for the last three months. A second instalment of the grant would be given after the person has worked there for four months.

4.2 Policies aimed at reducing skills shortages

The State Employment Agency offers a variety of competitiveness raising activities:

- Informal education, such as ICT (with and without previous computer programming knowledge); Latvian, English and German languages; driving (B-F categories); and project management.
- Professional education and requalification where the training offered aims to correspond to the most demanded jobs based on surveys of employers.
- Practical training with an employer is another mechanism aimed specifically at addressing the skills mismatch.

Table 2 shows the employment rate of these measures.

Table 2: Employment rate of participants in active labour market measures

	Ended participation between 01.20.2010-30.09.2011	Found employment in the following 6 months	
Activity	Total number	Total Number	Share
Professional education, requalification or increase in qualification	6925	2319	33.5 %
Practical training at the employer	1048	973	92.8 %
Informal education	30791	8784	28.5 %
Measure for unemployed representing disadvantaged groups	935	805	86.1 %

Source: State Employment Agency

The participation of the long-term unemployed in these programmes is an interesting indicator. According to the State Employment Agency for the period 1 January 2010 to 31 May 2012, the share of long-term unemployed in the following measures was as follows:

- Competitiveness raising 35.7 %
- Employment in municipalities 24 %
- Informal education 17.2 %
- Temporary public works 10.3 %

From the current registered long-term unemployed who have participated in active measures, 45.7 % participated in 2 programmes, 29.9 % in 3, 14.6 % in 4 and 9.8 % in 5 activities.

It has to be said, that even though these programmes raise the qualifications of the unemployed, they often are still not sufficient to meet the demand for high-quality professional labour and often in practice require a higher level of education.

4.3 Unemployment benefits system

On the face of it, the Latvian unemployment and social assistance system is not particularly generous and hence appears unlikely as a factor in long-term unemployment. Unemployment benefits are paid for the first nine months of unemployment, with a diminishing scale of benefits, which depends on the number of years worked and the previous wage. The initial replacement rate varies between 50 % and 65 % of the previous income. However, for long-term unemployed this is not really relevant since their benefits have already been exhausted. In fact, according to State Employment Agency data, only 26.6 % of the registered unemployed were in receipt of unemployment benefit in 2011.

Social assistance in the form of the guaranteed minimum income (GMI) is set at LVL 40 (EUR 56) per adult and LVL 45 (EUR 63) per child. The benefit is means-tested which means that income is subtracted from the benefit sum, including the income for participation in State Employment Agency programmes. However, entitlement to GMI also brings other benefits, such as housing benefits and free medicine. Therefore, there is a view that for some households the system provides insufficient incentives to work at the minimum wage (currently LVL 200 gross per month (EUR 287) or at some fraction of the minimum wage¹².

A recent reform to the social assistance system aims to remove the perceived disincentive to work effect. From 1 January 2012 it has been mandatory for recipients of social assistance to register as unemployed with the State Employment Agency. This resulted in a sharp increase in registration of long-term unemployed. For instance, at the beginning of 2012, in State Employment Agency branches in the Latgale and Kurzeme regions, the share of unemployed who had not held down a paid job for the last five years increased by 4 and 3 percentage points respectively as compared with December 2011. Overall in the country, the share of such workers among the newly registered unemployed increased from 8 % in December 2011 to 10 % in February 2012, but fell to 7 % in May. The key incentive effect of the registration requirement is that in order to retain the status of unemployed (and hence entitlement to social assistance), a person cannot reject more than two suitable job offers. However, during 2011 and the first half of 2012, no instances of de-registration took place.

5. Conclusions

The persistence of major long-term unemployment in the context of an expanding economy and falling overall unemployment has caught the Latvian authorities by surprise and only now, are measures under consideration to address the problem. There is now some recognition that despite the low absolute level of social assistance, the system may nevertheless contain disincentives to work. The evidence that 45 % of WWS participants participated in the measure more than once suggests the 100 LVL (EUR 142) net per month (later reduced to 80LVL [EUR 114]) represents for many an acceptable alternative to working in a normal job. The 100 LVL benefit was equivalent to 80 % of the net minimum wage in 2009 and less than 60 % of the cost of a minimum subsistence basket¹³. The truth is that very little is known about the effective marginal tax rates implicit in the social assistance system and hence about quantitative indicators of the incentives to take a job. In this context, the recent agreement with the World Bank to carry out research evaluating the efficiency of the system of benefits and activity measures is very welcome.

¹² Anecdotal evidence suggests that in many cases people have a work agreement for about half the minimum wage, but in practice work full time.

¹³ The 80 LVL represents 55 % of the net minimum wage and 46 % of the cost of the subsistence basket.

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