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# Labour Flexibility and Migration in the EU Eastward Enlargement Context : The Case of the Baltic States

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# LABOUR FLEXIBILITY AND MIGRATION IN THE EU EASTWARD ENLARGEMENT CONTEXT: THE CASE OF THE BALTIC STATES

**Tiiu Paas**
**Raul Eamets**
**Marit Rõõm**
**Rena Selliov**
**Anne Jürgenson**
**Jaan Masso**

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**Jean Monnet Centre of Excellence**

**Freie Universität Berlin**
**Ihnestr. 22, 14195 Berlin, Germany**
**Phone: +49 (30) 838 – 54966**
**Fax: +49 (30) 838 – 52357**
**Email: info@ezoneplus.org**

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# LABOUR FLEXIBILITY AND MIGRATION IN THE EU EASTWARD ENLARGEMENT CONTEXT: THE CASE OF THE BALTIC STATES

The eastward enlargement of the European Union and the requirements of the European Monetary Union increase pressure for flexibility of labour markets. This paper analyses main changes in the Baltic States' labour market over the period 1990 – 2001 giving emphasis on the problems of labour market flexibility and migration in the EU eastward enlargement context. Labour market flexibility issues are analysed paying attention to wage flexibility and institutional flexibility (regulations, labour policy, trade unions) while labour migration problems are discussed giving emphasis on pull and push factors of migration and on labour migration experience during the previous stages of EU enlargement. In conclusion labour market flexibility is relatively high in all three Baltic States, being a bit higher in Estonia and lower in Lithuania. In all three states the flexibility has declined in the course of transition. The weakness of the trade unions compared to EU has contributed to the high wage flexibility, while the insufficient funding of labour policies and high share of passive measures might have had negative effect on flexibility. Labour migration from the Baltic States into the EU15 countries will not be significant in the near future. Still the free movement of labour will have pressure on the labour markets of the Baltic States due to possible movement of better-qualified and flexible labour force and due to possible cross-border movement of workers in the Baltic Sea region.

*JEL–Classification*: J21, J30, J50, J61, J80, H50

Keywords: Labour market flexibility, labour migration, Baltic States, eastward enlargement of the European Union

Corresponding authors:

Prof. Ph.D. Tiiu Paas. & Ass. Prof. Ph.D. Raul Eamets
Institute of Economics
University of Tartu
Narva mnt. 4-A208
EST-51009 Tartu
tpaas@mtk.ut.ee. eam@cie.ut.ee.

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# 1. Introduction

The Eastern enlargement of the European Union and the requirements of the European Monetary Union (EMU) increase pressure for a flexibility of labour markets in both the current EU members (EU15) and candidate countries (CC)[1]. In conditions of EMU and in order to follow the requirements of optimal currency area (OCA) the growth of labour flexibility is unavoidable. If labour markets and institutions do not become more flexible, the growth of market disequilibrium is highly probable in both groups of countries.

The EU candidate countries have to combine transition processes with the requirements of the accession. Labour markets of the candidate countries deserve special attention because of their flexibility may be needed to offset asymmetric shocks, especially when other means such as monetary and fiscal policies are constrained. If labour markets of the accession countries fail to adapt to the challenges of monetary union, the convergence process will be hindered. This, in turn, may result in high unemployment and growth of labour migration. Social conflicts are possible in the accession countries as well the EU current member states.

The first round of EU eastward enlargement will take place earliest in 2003 or 2004. Of the former Soviet republics only the Baltic States are EU accession candidates. The Baltic States' favourable location between East and West, historical and cultural traditions of cooperation with the countries around the Baltic Sea, and market economy experience of the period between the two world wars are important initial conditions as determinants of transition influencing economic development and the EU accession processes of these countries. After regaining their independence in 1991, the Baltic States' governments have followed almost similar principles of economic policy that were directed to solving the following main tasks: 1) liberalization of prices and gradual elimination of all state subsidies; 2) privatisation of state owned enterprises; 3) introducing a separate currency by means of a currency board system (Estonia and Lithuania) or regular pegs (Latvia); 4) maintaining conservative fiscal policy; 5) implementing a comparatively liberal foreign trade regime.

The Baltic States are providing an interesting case for generalizing transition and EU eastward enlargement processes and developing a new field of economics – economics of transition

[1] Candidate countries (CC10) are Hungary; the Czech Republic, Slovenia, Poland, Slovakia Estonia, Latvia, Lithuania, Romania and Bulgaria.

and integration. Real influence of the Baltic economies on the EU eastward enlargement processes can not be significant due to very small size of the Baltic markets comparing to the markets of the EU current member states as well as the candidate countries. The share of the Baltic States' population is only 2% of the EU15 and 7.4% of CC10 population. The GDP of the Baltic States is forming about 0.3% of the EU15 and 6.3% of the CC10 total GDP. The level GDP per capita (PPP) is only about 30% of the EU15 countries respective indicator (34% in Estonia, 26% in Latvia and 28 % in Lithuania) (Straubhaar, 2001, p. 170). According to the same estimation, the convergence process of the Baltic States with the EU GDP per capita average will take more than 50 years (till 2054 in Estonia, 2065 in Lithuania, and 2068 in Latvia) *(ibid*).

The aim of the paper is to give an overview of the main changes in the Baltic States' labour market over the period (1990 – 2001) giving emphasis on the problems of labour flexibility in the EU eastward enlargement context. In the first part of the paper (section 2) the main trends in development of employment and unemployment are described. Unemployment, the politically most important indicator, which was relatively modest during the first years of transition, is continuing to be high now in all three Baltic States (Estonia 13.9%, Latvia 14.7 and Lithuania 15.9 in 2000). At the same time mobility of labour is declining comparing with the first period of transition, particularly in the case of Estonia, where transitions to and from employment, unemployment and non-participation have been relatively high in the beginning and middle of 90s.

The second part of the paper analyses labour market flexibility issues paying attention to the macro level of this concept. Section 3 discusses different aspects of the notion of labour market flexibility. Flexibility of labour market on the macro level can be divided into wage flexibility and institutional flexibility. Wage flexibility denotes how responsive wages are to market fluctuations. The institutional flexibility characterizes to what extent state institutions and trade unions are involved in the regulation of the labour market. These different aspects of labour market flexibility are interrelated. If institutional involvement is high, decrease of labour flexibility could be the consequence. In case of trade unions weakness, wage flexibility is usually high. According to that logic the discussion of institutional flexibility (section 4) precedes the section on wage flexibility (section 5).

Labour migration problems are discussed in the section 6 of the paper giving emphasis on pull and push factors of migration and on analysis of labour migration experience during the

previous stages of EU enlargement. In the case of the Baltic States labour movement is mostly expected within the Baltic Sea region. The Baltic Sea region (Denmark, Germany, Sweden, Finland, Norway, Poland, Estonia, Latvia, Lithuania and Russia) has become one of the most competitive economic regions in Europe due to its favourable location between East and West and the dynamic interdependence between transition and integration. The possibilities for cross-border movement of the Baltic States' labour force are also discussed in this part of the paper.

## 2. The main changes in the Baltic States' labour markets in 1999-2000

As in most other transition economies of Eastern Europe, the size of the population in Estonia and Latvia fell rather sharply in the early 1990s, and it continued to decline in the late 1990s, albeit more moderately. The decline reflects both negative natural increase (births minus deaths) and negative net migration (immigration minus emigration). At the same time, the Estonian and Latvian populations also aged quite substantially over the whole last decade, with a particularly large drop in the percentage younger than 15 years old (due to a drop in fertility). As a result, the working age population has been much more stable in size, and it actually increased slightly in Latvia in the second half of the 1990s.

In Lithuania, by contrast, the population declined only negligibly. While the rate of natural increase was negative, the magnitude was much smaller than in Estonia and Latvia. Moreover, Lithuanian net migration has been close to zero, and in some years it was even positive. Like in Estonia and Latvia, however, the Lithuanian population has aged significantly, although it was still the youngest (the highest share younger than 15 and smallest share above 65) at the turn of the century.

Following the pattern in most other East European economies, the activity rate (labour force participation rate) declined sharply in all three Baltic countries. There are some differences in variation in labour force participation and employment rates across gender and age groups. The levels of the rates overall, by gender, and by age group are quite similar across countries, but some of the trends are markedly different. The declining participation in Estonia and Latvia over these four years, whether measured with respect to the over-15 population or just for ages 15-64, holds roughly equally for both genders, while in Lithuania a falling male participation rate was largely offset by a rising female rate. By age, the biggest changes in participation tend to take place for the youngest and oldest groups. In Estonia, the decline in

participation is greatest for the 15-19, 35-39, and 45-49 categories, while the oldest groups of 60-64 and 65+ increase their participation; this increase is equal for men and women aged 60-64, but it consists entirely of women in the 65+ category. Lithuania also shows increases in participation for all groups over 50 years of age and declines among youths and teenagers, but the gender pattern differs by age group. In Latvia, by contrast, there is only slight change in participation in the age range from 25 to 59, but big declines for both younger and older individuals. This pattern is common to both men and women, except for a large decline in the participation rate of women aged 25 to 29 and a corresponding rise for men in the same age category. In the oldest group of 65+, the Latvian participation rates for both genders went from the highest in the three countries in 1997 to the lowest in 2000.

The difference between the magnitude of the decline in activity and the employment decline is of course mirrored in the rise in unemployment. The Baltic States have experienced some of the highest levels of the unemployment rate in all East European economies, with maximum rates of 13.7 in Estonia (2000), 19.4 in Latvia (1996), and 17.1 in Lithuania (1995). After peaking in the mid-1990s, the unemployment rate fell back in all three countries, but while the pattern in the late-1990s has been continually falling in Latvia, it has been U-shaped in Estonia and Lithuania. The rise in the latter two countries was particularly steep in 1999 and 2000, perhaps due to side-effects of the Russian crisis. By 2000, the rates were roughly equal in all three countries, in the 13-15 percent range.

Figure 1 allows comparing activity and unemployment rates in the Baltic States with other CEE countries, as well as established market economies. While activity level in the Baltic States is roughly equal to the EU average and similar to what is found in Slovenia, Romania, Czech republic and Slovenia, it is lower than in the Nordic countries and the US but higher than in Poland, Hungary and Bulgaria. Unemployment rates in Estonia, Latvia and Lithuania are significantly higher than in EU, Hungary, Romania, Slovenia and Czech Republic, but somewhat lower than in Bulgaria, Slovakia Poland. The unemployment rates discussed so far were calculated using the standard ILO methodology based on LFS data, and are therefore relatively easy to compare internationally. Also of interest, however, are registered rates of unemployment, based on individuals appearing at local labour offices in search of work. The registered rates are substantially lower than the ILO rates, and the former only exceed the double-digit level in Lithuania in 2000.

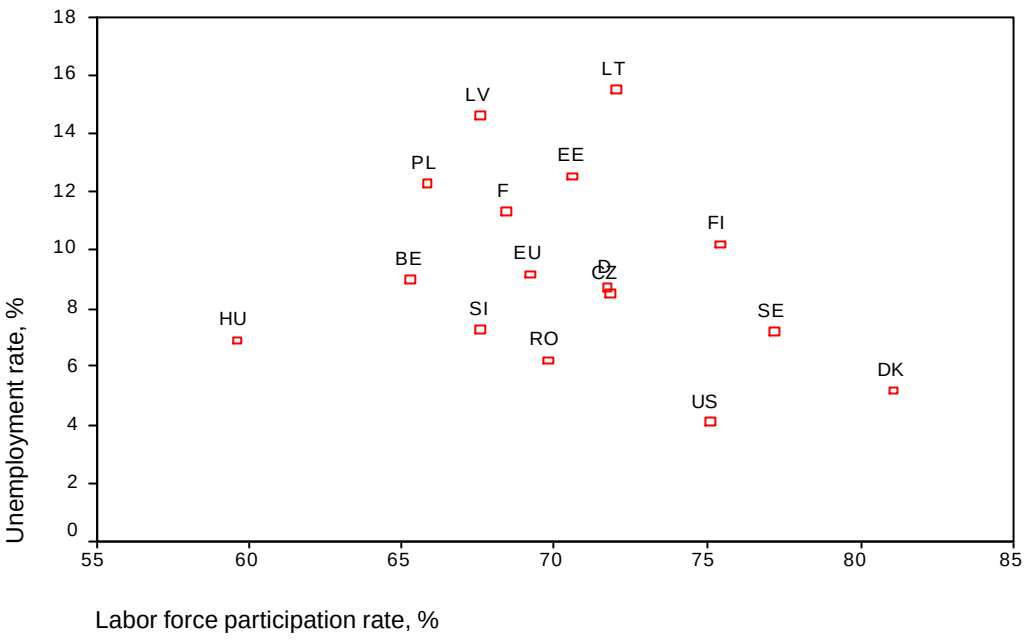


**Figure 1 Unemployment *vs.* participation rate of population aged 15-64 in selected Central European and OECD countries [a], 1999**

Political, economic and social reforms have completely reshaped the labour markets of all the transition countries. The immediate reaction to economic uncertainty was a sharp decline in demand for labour. External shocks such as the break-up of the USSR and the collapse of the common market of the former Eastern bloc occurred during the same period as internal shocks caused by economic reform and stabilization programs. This combination resulted in sharp production losses and pulled the national economies of these countries into a dragging transition crisis. There was a certain delay before the effects on employment were felt, as enterprises were at first reluctant to dismiss redundant workers, assuming that the economic recession would be a short-term crisis. As economic pressures intensified, the effect on employment in the different countries was determined by a number of factors, such as the scale of initial imbalances, the speed of reform, the type of privatization and the progress made, proximity to Western countries, and entrepreneurial tradition.

The transition process brought fundamental changes to the composition of employment by sector and by branches. The changes in the shares of each of these sectors over the 1990s are shown in figures at pages 9 and 10.

If we analyze all CEE countries the serious employment losses were experienced by the industrial sector (Latvia, Romania and Lithuania) and in the most countries in agriculture. Most dramatic decline of agricultural employment took place in Estonia where total

employment dropped from 140 thousand (1989) to nearly 30 thousand in 2001. A decline in the range of 80% is a very serious one and as a result we can observe the increasing long-term unemployment in many rural areas in Estonia. Agricultural employment declined in other countries as well, except Romania and Lithuania. This is rather interesting phenomenon, because both countries are characterized by agriculture with small and medium-sized private farmers. These farmers are the owners of small plots of land, which they cultivate with extremely modest technical means. In general, they have been able to earn only small incomes from sales of their production on the local market. The same is true also for countries like Latvia and Estonia, where we can observe at the same time drastic drop of employment. One explanation for Lithuanian increasing agriculture sector might be high state subsidies and high tariffs to food import. Another reason for the increasing (or stable) employment in the agricultural sector in Lithuania was the fact that during the privatization process the land was distributed free of charge to those who were employed in the agriculture at that time. As the mobility of workers was low due to the underdeveloped housing markets and poor infrastructure, the people chose to stay in land and worker in agriculture rather than be unemployed.

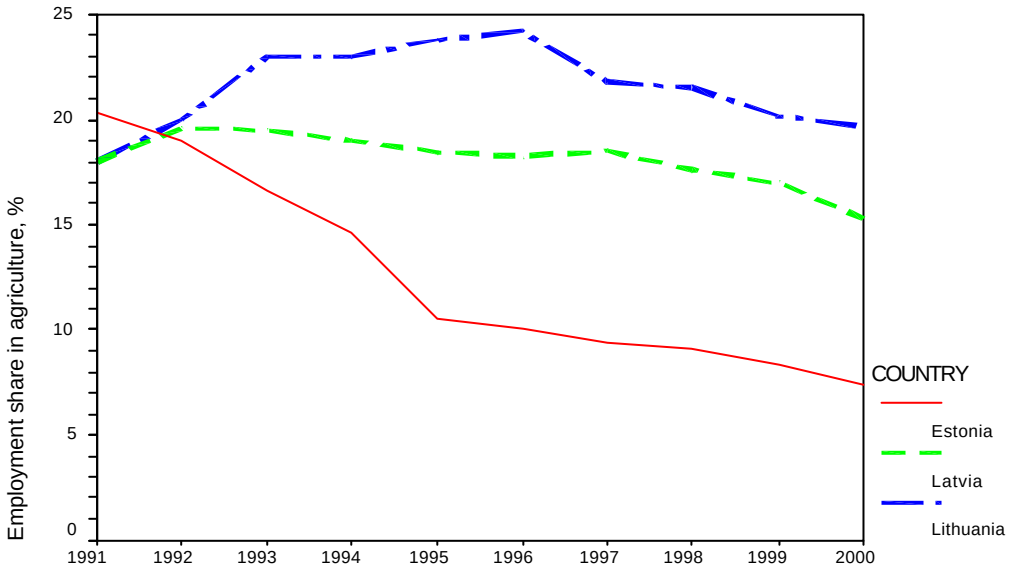


**Figure 2 Employment in agriculture [a] (percent of total employment) in the Baltic States, 1991 -2000**

*Notes*: [a] Agriculture, hunting, forestry and fishing. *Source*: Statistical yearbooks of the Baltic States.

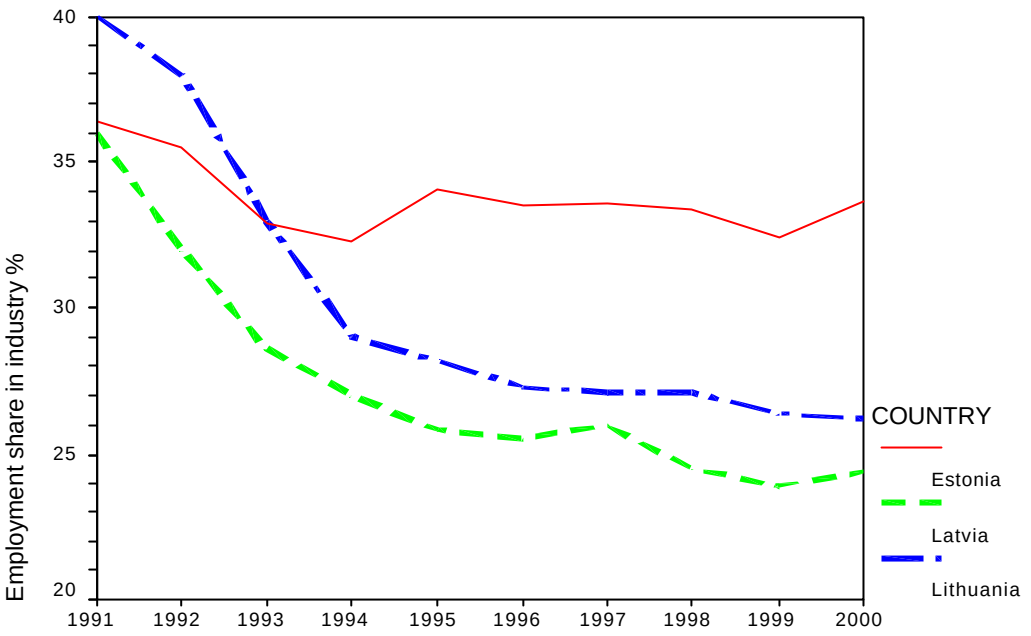


**Figure 3 Employment in industry [a] (percent of total employment) in the Baltic States, 1991 –2000**

*Notes*: [a] Mining and quarrying, Manufacturing, Electricity, gas and water supply, Construction. *Source*: Statistical yearbooks of the Baltic states.

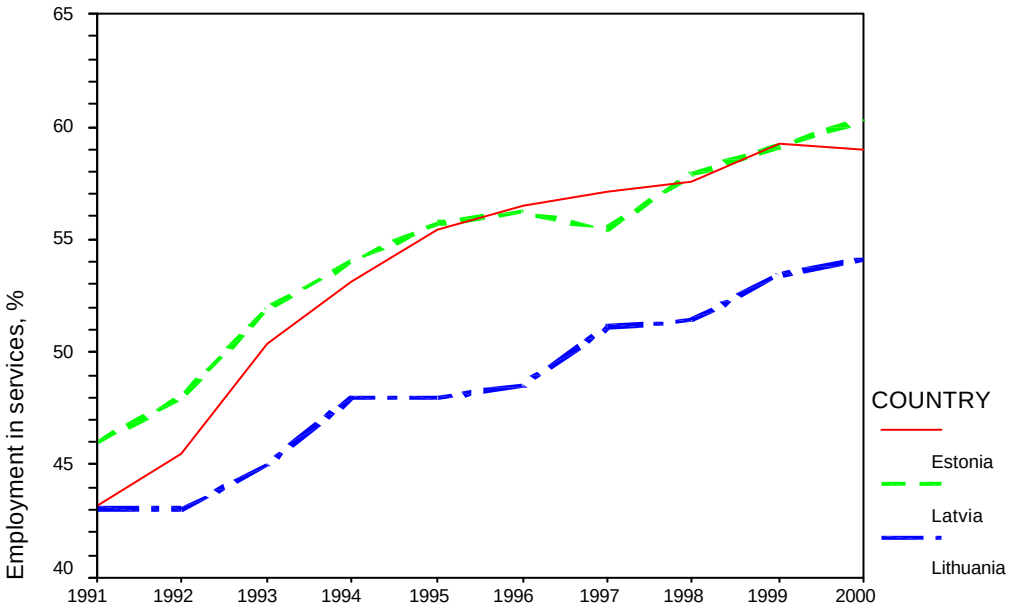


**Figure 4 Employment in services (percent of total employment) in the Baltic States, 1991 –2000**

*Source*: Statistical yearbooks of the Baltic states.

The share of employment in service sector is largest in Hungary, next are Estonia and Latvia. Also we see "industrialized" countries, like Czech Republic, Slovakia and Slovenia in our sample, where around 40 % of people are employed in industry. Finally we have

"agricultural" countries like Romania, but also Bulgaria, Lithuania and Poland. If to look the dynamics of shares of different sectors and analyse how this distribution was achieved, we see that in agriculture we have clearly two groups of countries. One group represents countries where employment share of those who work in agriculture is around 20 % or higher and other group where the same share is 10 % or less. The low employment in agriculture in developed countries is based on high effectiveness, while in most of CEE countries we are simply dealing with decreases in production. We should also keep in mind that we are dealing here the overall decollectivization of agriculture and the re-establishment of small and medium-sized private farmers. The only exception was Poland where agriculture was based on small farms also before economic reforms.

The results of these sectoral shifts in employment shares are presented in the figure 2.5.

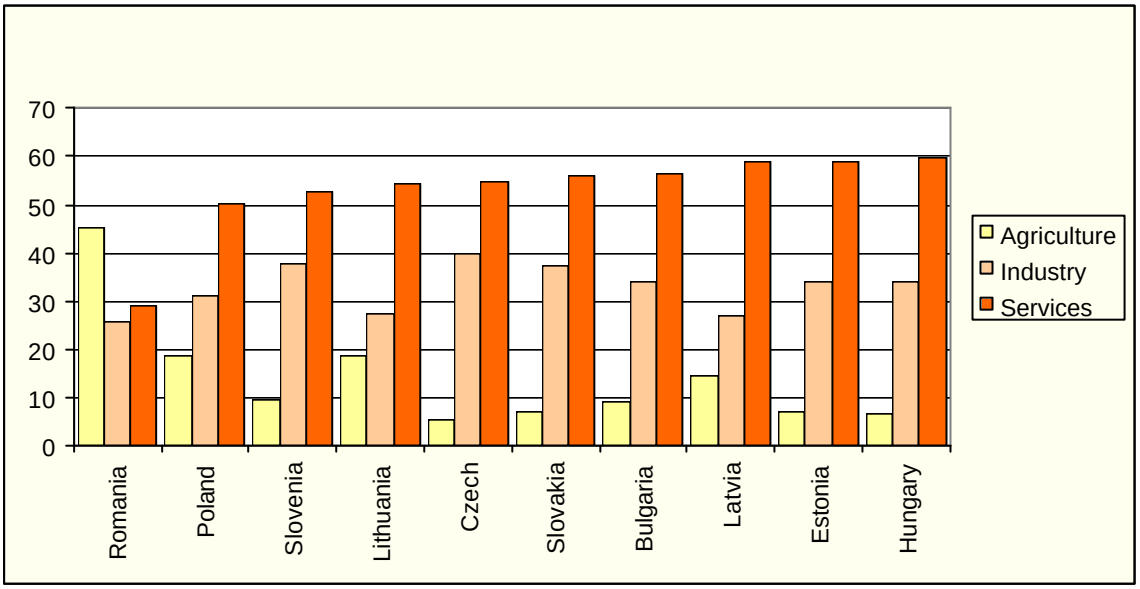


**Figure 5 Employment by three economic sectors in CEE countries, 2000**

*Notes*: Agriculture (including Agriculture and hunting, Forestry, and Fishing), industry (Mining and quarrying, Manufacturing, Electricity, gas and water supply, Construction) and Services (all other activities). Employed aged 15-64 included.

The extent to which industry has been down-sized and services have grown is sometimes taken as a measure of progress in transition towards a market economy, and the service sector is well-developed in Latvia and Estonia, and slightly less so in Lithuania. Compared with some other transition economies (e.g., Romania and Russia), industrial employment has declined relatively little in the three Baltic States, especially in Estonia, where its share is still above 30 percent. The service sector has grown most strongly in Estonia, where the share increased from 43 to 59 percent.

# 3. The concept of labour market flexibility

The term labour market flexibility has been given many definitions. Wage and employment flexibility are intuitive enough concepts. But there are also numerical versus functional flexibility, internal versus external flexibility and, for the most exigent, the intensive and the extensive margin of flexibility. Indeed, the term labour market flexibility has been given so many definitions as to arouse the suspicion that one is grappling with a catchword devoid of any theoretical rigor.

This is not entirely true. From the point of view of general equilibrium theory, perfect flexibility may be thought of as a situation where all resources on a given market are allocated in a Pareto efficient way (Hahn, 1998, p. 4). But it could be also argued whether we treat this term as characterizing state or process. It seems to be more appropriate to describe with the term of flexibility the process. For instance, one market is more flexible if it moves towards Pareto efficient resource allocation faster than other market. In principal it means that we use the framework of neoclassical equilibrium model and any kind of intervention to labour market will slow down adjustment speed. So, we can say that labour market flexibility shows adjustment speed to the external shocks. Or in the other words, how fast labour market reacts to the changing macroeconomic conditions.

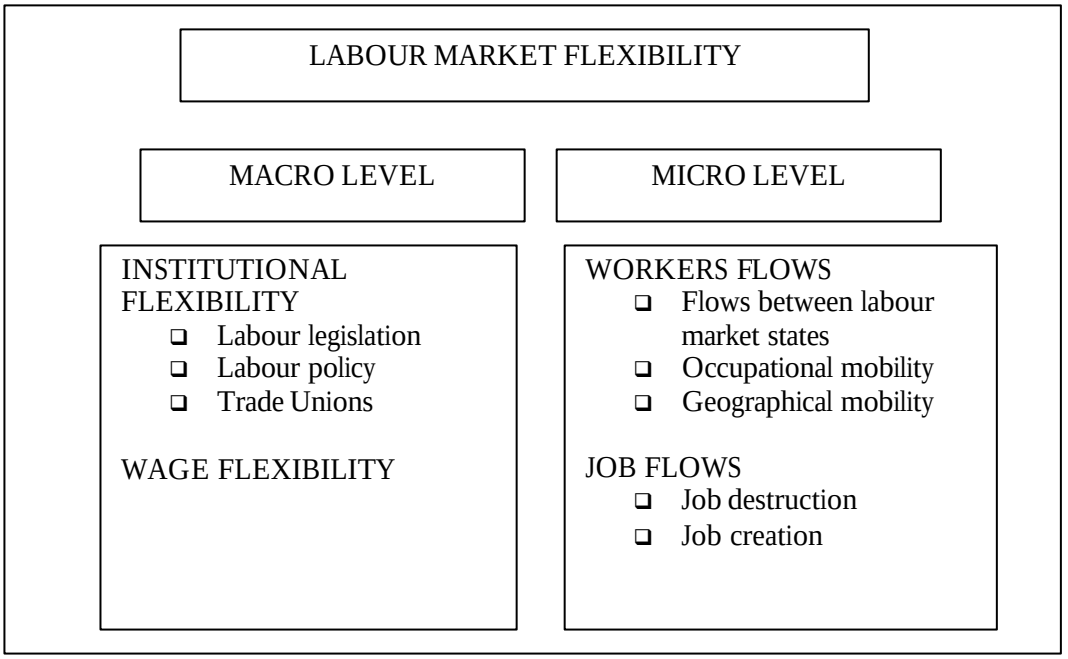


**Figure 6 The concept of labour market flexibility.**

This definition is very broad and it is very difficult to measure empirically such effects as adjustment speed. Therefore in practical reasons this term has a wide range of applications. For example Treu (1992) considered numerical (or external) flexibility, i.e. the freedom employers enjoy to expand or contract their workforce as they wish and to employ workers on a temporary or part-time basis; working time flexibility, functional flexibility; and pay flexibility. These terms are presented and explained using examples from EU.

The issue of employment protection, in particular the regulation of dismissals, has been widely discussed. The European labour relations systems, which all have some institutionalized system of protection against dismissal provided both by law and by collective agreement, have been contrasted at length with the extreme models presented by the United States, traditionally characterized by the legal freedom to dismiss (Grenig, 1991), and Japan, well known for its practice of lifetime employment, at least for the core labour force (Dercksen, 1989). The level of employment protection and the forms of negotiated flexibility described mostly the permanent labour force. This picture would be misleading if we failed to consider the various forms and growing incidence of "atypical" employment. The introduction of different types of employment contract has probably been the major development in European law and practice in the labour field during the past 15 years and has played a leading role in increasing labour market flexibility (Kravaritou-Manitakis, 1988).

Working time was another important and controversial testing ground for flexibility in Europe, particularly in the late 1970s. Far-reaching changes have taken place in this area, possibly even greater than those in respect of employment protection (Treu, 1989). The initiative for change came mostly from the employers. Although the trade unions initially reacted defensively, there did emerge the outlines of a consensus on the needs and values of a workforce that now contained more women and more people working in the tertiary sector. However, the trend towards more flexible working patterns was also influenced by union pressure for reduced working hours, which met with considerable (and continuing) success in a number of countries (Treu, 1992)

Functional flexibility involves a reversal of the division of labour and the fragmentation of work organization which were typical of the traditional production-line model; this is achieved both by extending the range of tasks and skills involved in a job and by increasing internal mobility. The traditional rigidities attributed to European labour relations in this area derive not so much from legal restrictions as from management and union practices, which

reflect the basic nature of labour-management relations in Europe and of company strategy and organization. For this reason they have been called "built-in rigidities" (Boyer, 1988; Dore, 1986).

Functional flexibility has come to be widely accepted and practised throughout the European Union. Research evidence suggests that there was a significant trend towards greater functional flexibility throughout the 1980s (Bamber, 1989).

Wages have not remained untouched by the pressures for greater flexibility. Indeed, the failure of companies to adjust to turbulent markets has repeatedly been blamed on the complexity and rigidity of wage structures. The need for change has been widely recognized.

In Europe wages are determined mainly through collective agreements, so here too the introduction of flexibility has been a major task for the social partners. However, legislation has also played some part in reducing certain forms of automatic wage increases, particularly indexation. During the 1980s indexation came under attack as a major factor contributing to inflation, and in most countries its use was gradually reduced, if not abolished, under the combined influence of legislation and collective bargaining.

Simonazzi and Villa (1999) treated labour flexibility from the point of view labour market flows, employment elasticity and state intervention on employment. The labour market is characterised by various flows and transitions to and from employment, unemployment and non-participation, as well as flows of job creation and job destruction. The standard measures used to analyse labour market dynamics - i.e., net changes in employment and unemployment - conceal an important dimension of the functioning of the labour market: job turnover (job creation and job destruction at the level of individual firms) and labour turnover (movements of individuals into jobs, i.e. hiring, and out of jobs, i.e. quits, over a particular period of time). Consequently, analyses that focus on labour market flows may yield more information about the adjustment abilities of the labour market than analyses of the levels of employment and unemployment. It is probable that the institutional innovations introduced into the labour market to produce greater flexibility have increased employment's response to variations in output. Morgan (1996) compared employment elasticity in relation to variations in production for two periods, before and after the introduction of significant reforms in labour market institutions in Spain, Italy and Germany, to conclude that elasticity has in fact increased, and that in Spain and Italy employment has now become more variable than production. In the

case of Germany, comparison between the two recession phases 1981-83 and 1992-94 reveals a much higher rate of job destruction in the second (although the dismantling of industry in eastern Germany may have contributed to this result).

Many empirical studies have sought to assess the effects of various types of state intervention on employment, including unemployment benefits, financial support for employment and the minimum wage. The results are disappointing for the defenders of the flexibility approach: both analyses focusing on policies that affect labour cost and those that consider the impact on the replacement ratio yield contradictory results, when they do not actually clash with the expectations of flexibility theories (Gregg & Manning, 1997).

On the labour demand side, it has been estimated that wage subsidies intended to save jobs or to create new ones actually involve 'dead weight and displacement effects amounting to 75-90% of outlays, implying that only 10-25% of expenditure generates a net job gain' (European Commission, 1996, p. 138). There is complete disagreement on the actual efficiency of policies aimed at enhancing the elasticity of labour supply. Unemployment benefits (guaranteed for long periods) appear to play an important role in explaining persistent unemployment in some studies (Ball, 1996, Jackman et al., 1996), but not in others (Revenga and Bentolila, 1995; Blanchard and Jimeno, 1995). Reduction of firing costs, as well as the bargaining power of insiders, is important for Revenga and Bentolila (1995), but not for Jackman et al. (1996) who argue that reducing the degree of employment protection would in fact lead to a reduction in long-term unemployment but also to an increase in short-term unemployment, with scant effect in terms of any net increase in employment. Scant effects would also be obtained (according to Jackman et al., 1996) by reducing social security contributions and working hours, while active policies aimed at retraining and help in job search would have positive effects. Finally, no definitive result has emerged from the now vast theoretical and empirical literature on the effects of the minimum wage on employment (Simonazzi and Villa, 1999).

Most common interpretation of labour market flexibility is connected with labour market regulations and institutions (For example Siebert, 1997; Berthold and Fehn, 1996; Jackmann, Layard, Nickell, 1996; Lazear, 1990). In all OECD countries, there are rules and regulations that govern the employment relationship between workers and firms. Those referring to hiring and firing practices are often referred as employment protection legislation (Boeri, 2000). These rules and regulations govern unfair dismissals, restrictions on lay-offs for

economic reasons, compulsory severance payments, minimum notice periods and administrative authorizations.

Nickell (1997) pointed out three aspects of labour market flexibility: employment protection, labour standards and labour policy. The employment protection index was drawn up by the OECD and is based on the strength of the legal framework governing hiring and firing. The labour standards index refers to the strength of the legislation governing a number of aspects of the labour market. The index ranges from 0 to 10 of the five dimensions: working time, fixed-term contracts, employment protection, minimum wages and employees' representation rights (on works councils, company boards and the like). Labour policy was divided into active and passive labour policy. Benefit systems were characterized by replacement rate, which shows what share of income is replaced by unemployment benefits, and the duration of these benefits. Active labour market policies refer to expenditures on activities for the unemployed that are geared to help them back into work. These include labour market training, assistance with job search, subsidized employment and special measures for the disabled.

Although the question of whether and to what extent job security regulations adversely affect labour market flexibility remains a matter of continuing controversy. Critics have claimed that strong job rights prevent employers from adjusting to economic fluctuation and secular changes in demand. It also has been alleged that, by inhibiting layoffs during downturns, strong job security provisions reduce employers' willingness to hire during upturns and thereby contribute to unemployment. (OECD, 1986). For instance if employment protection legislation leads to long- lasting work relationship, it may encourage employers to provide training to workers with potentially beneficial effects of human capital and labour productivity. A better skilled worker may also increase internal flexibility (functional flexibility) and thus lead to a better functioning of production activity (Piore, 1986). However, if these regulations are very strict, as in many European countries, firms may become more cautions about adjusting their workforce with the ultimate effect of reducing labour turnover, e.g. movements from employment to unemployment and from unemployment to employment (Bertola, 1992).

Several empirical studies have tried to measure the effect of job security legislation on labour market outcomes. Bentolila's and Saint Paul's (1992) use a "before and after" approach to analyze the Spanish case. They show that labour demand fluctuated more in response to

output shocks after flexible employment rules were adopted. Houseman (1991) uses data from Western Europe steel plants and offers evidence that more restrictive policy on severance payments slowed down job creation.

If we consider the tightness of the country's employment protection legislation as a proxy for labour market flexibility, we can see that Western European countries have relatively inflexible labour markets (Bertola, 1990; Grubb, Wells, 1993).

With continued attention focused on labour market flexibility, OECD Secretary-General Jean-Claude Paye established a high-level group of experts with a background in business, labour, and government to review the entire field of labour market flexibility and to report on the available policy options. The group identified six categories of labour market flexibility and made recommendations for each (OECD, 1996):

- Labour costs: avoid mechanisms, whether institutional or automatic, that would lead to wage increases greater than productivity increases;
- Conditions of employment: strike a balance between workers' desire for job security and the needs of economic efficiency;
- work practices and work patterns: modify the organization of work to enrich work content and raise levels of skill and to provide increased flexibility in the arrangement of working time;
- rules and regulations: apply rules and regulations in a reasonable manner and reassess their direct and indirect impact at regular intervals;
- mobility: remove obstacles to mobility such as non-transferrable pension arrangements and rigid housing markets;
- education and training: improve initial schooling, strengthen retraining programs, and publicize the importance of lifetime learning for a flexible society.

Previous sections show that there exists variety of understandings and interpretations of flexibility concept. Next we try to present an idea or concept how these different flexibility interpretations are interrelated and connected with general labour market behaviour. At the beginning we should do some simplifications. First, we will concentrate in our discussion to transition economies labour market; secondly, we assume that restructuring and labour reallocation is dependent on labour market flexibility. More flexibility means faster

restructuring and reallocation[2] Thirdly, we will draw our theoretical framework from OST (Optimal speed of transformation) literature, first introduced by Aghion, Blanchard (1994)

The backbone of the literature on optimal speed of transition is the paper by Aghion and Blanchard (1994). Aghion and Blanchard found that countries, which had a large initial shock and thus a large increase in unemployment, are likely to restructure more slowly. From their model we can conclude that gradualism in implementing reforms is the better policy choice. According to them the transition was shaped by two main mechanisms. One they called reallocation and the other restructuring. Reallocation means the changes in employment structure, how labour is allocated between economic sectors. Restructuring here means not only changes in the structure of ownership, but also changes in the structure and the organization of their production. Firms must redefine their product line, close some plants that are no longer needed and lay off workers in those plants. They must also reduce labour hoarding. Also they must replace most of their equipment and train/replace the managers.

So we have two keywords: reallocation and restructuring. According to our concept both are dependent on labour market flexibility. Via labour reallocation and restructuring economy reaches Pareto optimum resource allocation and this enables efficient use of resources and higher productivity. Comparing two economies, if one's labour market is flexible then transition to higher productivity is faster there than in the economy where we have rigid labour market. As far as most of transition economies are concerned on the convergence and catch up strategies, the issue of labour market flexibility becomes crucial for them. Secondly we believe, that higher flexibility means lower unemployment, because matching process is more successful and as result we have less long term unemployment than in rigid labour markets.

We argue that labour market flexibility should be measured at two different levels: the macro level and the micro level. Macro level flexibility can, further, be divided into institutional flexibility and wage flexibility. The institutional flexibility of labour market denotes to what extent state institutions and trade unions are involved in the regulation of the labour market. Wage flexibility denotes how responsive wages are to market fluctuations. Micro level

[2] This phenomenon characterises labour markets in transition economies. The dependence has also opposite direction, if market situation has stabilised, also institutional stability is achieved, then reallocation and restructuring will slow down and finally we can see fewer flows in labour market and less flexibility. In a way we can say that less flexibility shows that restructuring and reallocation (needed for transformation) will soon be over.

flexibility relates to labour market flow analyses. The labour market can be characterized by various flows of transitions to and from employment, unemployment and non-participation, as well as flows of job creation and job destruction. The standard measures used to analyze labour market dynamics – i.e. net changes in employment and unemployment – conceal an important dimension of the functioning of the labour market: job turnover (job creation and job destruction at the level of individual firms) and labour turnover (movement of individuals into jobs, i.e. hiring, and out of jobs, i.e. leaves). Consequently, analyses that focus on the labour market flows may yield more information about the state of the labour market than do analysis of the levels of employment and unemployment. This paper concentrates on the macro side of the labour market flexibility (institutional flexibility and wage flexibility).

In practice different aspects of flexibility are interrelated, presumably in a hierarchical way. If institutional involvement is very high, workers transition rates are likely to be low. If trade unions are weak, then wages are more flexible. Thus, macro level flexibility can partly be measured via indicators of micro level flexibility. While it is generally difficult to measure quantitatively institutional involvement (although there are some indexes), it is much easier to measure workers flows, job creation and job destruction.

# 4. Institutional flexibility

## 4.1. Labour market regulations

This part of the paper reviews labour market legislation in Estonia, Latvia and Lithuania by its effect on labour market flexibility, discussing issues like the regulation of dismissals, regulation of work time and wages, the social protection of the unemployed. If not stated otherwise, similar provisions are valid in all three countries. In general there are five sources of legal regulation of labour relations in Latvian and Lithuanian jurisdictional system: 1) International conventions, 2) Constitution, 3) Laws 4) Decrees and regulations of administrative authorities, 5) collective agreements. The regulation of employment relations mainly corresponds to international standards: the most important ILO conventions are ratified and the legislation assures the protection of employees' rights in terms of work time, work remuneration, holidays, and termination of contracts.

## Work relations regulated by the employment contract

The work relations are regulated in Estonia with the Labour Contract Act, in Lithuania with Law of Employment Contract and in Latvia with the Labour Law[3]. In all countries the labour contract is an agreement between the employer and the employee, whereby employee is obliged to perform specific work and the employer shall pledge to pay the employee and guarantee certain working conditions. The rights and obligations provided by the employment contract do not apply to the other types of work like work in civil service. Such work relations will be discussed in the next subsection. For mandatory provisions of the employment contract see Appendix 4.

*Entry into employment contract*

The employment contract may be entered into for unspecified or specified term but the latter is allowed only in order to perform short-term temporary work and has a maximum duration 2 years in Latvia and 5 years in Lithuania and Estonia. Employees of specified and unspecified terms contracts have the same legal treatment. In Latvia and Lithuania the probation period of up to 3 month may be included in the contract in order to assess employees' suitability for the work. The maximal duration of the probation period in Estonia is 4 months and it is not allowed to use it on minors or disabled persons. During the probation period the employee enjoys the same rights. The provisions of the employment contract may not be less favourable to the employee as specified in laws.

*The status of the worker*

An employee may be a person who is in Latvia at least 16 (Lithuania and Estonia – 18) years old. There are restrictions for hiring younger persons. Minors enjoy equal rights with adults in employment relationships and disputes. Permanent residents have mostly equal rights with Estonian (Latvian, Lithuanian) citizens.

The laws prohibit differential treatment based on factors that do not affect professional qualifications but the Estonian and Latvian Labour Laws allow for differential treatment based on gender if that is an objective precondition for performance of the work. Laws specify benefits for persons with children and minors.

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[3] 3 The Republic of Latvia Labour Law (comes into force 01.06.2002). Translation and Terminology Centre [http://www.ttc.lv/en/default-translations-lr.htm]
Republic of Lithuania Law on the Employment Contract (12.06.2001). Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=151151&Condition2=]
Eesti Vabariigi Töölepingu seadus. (01.07.1992)
[http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=6668&akt_id=6668]

*The arrangement of work time and wages*

For regulation of wages see section 5. There is 40 days upper limit for the regular weekly working time. In Latvia also the regular daily working time may not exceed 8 hours. Regular time is reduced for employees exposed to special risks, adolescents and children.

The laws specify limitations for overtime work and for work during night – time as in European Union. The overtime is limited (in Latvia to 200 hours a year, in Lithuania – 120 hours a year; in Estonia – 200 hours per year and 4 hours per day). The overtime work may be organized only with the consent of the employee (except some cases). The additional compensation for overtime work is 100 % of established wage in Latvia and 50 % in Lithuania and Estonia. In Latvia and Lithuania there is 50 % compensation for work during night-time (in Estonia – 20 % for night-time, i.e. work between 10PM-6PM, in the evening time - 6 PM – 10 PM - must be at least 10%). The usual wage rate has to be doubled if the worker is required to work on holidays. It is not allowed to apply overtime or nighttime work to pregnant women and minors.

*Vacations and holidays*

The duration of regular vacations is 4 weeks (28 days) in all three countries, extended holidays are specified for employees with children, those exposed to special risk etc. The extended regular vacation of 56 calendar days is granted to the researchers and teachers. Special laws state the jobs with extra vacations. During the holiday the employer must pay in Lithuania and Estonia average wage, in Latvia 5/7 of average wage. In addition to annual paid leave there are pregnancy and maternity leave, parental leave, leave without pay, study leave (the latter only in Lithuania[4]).

*Termination of labour contracts*

The contract may be terminated on the initiative of the employee, on the initiative of the employer, expiry of the term, by agreement of parties, by the request of third parties. The advance notice for the termination of the contracts has to be given to the other party. The notice period varies according to the bases for termination. Both in Latvia and in Lithuania employers must give advance notice to local governments and labour exchanges about

[4] Republic of Lithuania Law on Holidays (01.07.1997) Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=43102&Condition2=]
Töö ja puhkeaja seadus (01.01.2002).
[http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=40006&akt_id=40006]

massive lay-offs. For details on the regulations of terminations see also Appendix 5, Appendix 6, and Appendix 7.

*The termination of the contract on the initiative of the employer*

There are several reasons to terminate employment contract: lay-off of workers, reasons connected with the employees' unsatisfactory or indecent behaviour, employees' unsuitability to perform work, unsatisfactory results of the probation period.

The notification period varies in Latvia from 10 days (misconducts of employee) up to 1 month (lay-offs). In Lithuania the period is 2 month (4 month for minors, parents of children etc.). The compensation for the termination varies in Latvia from 1 to 4 month average wage depending of the employers work experience with the present employee (according to the Labour Code valid till 1 June 2002 the compensations was no less than 1 month average pay and the notification period was 1 month[5]). In Lithuania the compensation varies from 1 to 12 average monthly wages depending on the reason of termination and the length of work experience with the present employer. In Estonia the notification period varies from 2 weeks (long-term incapacity for work) to 4 month (lay-off of workers who have continuously worked for the employer more than 10 years). The compensation for the termination varies form 1 to 4-month average wage.

The employer is prohibited to terminate the employment contract with pregnant woman, woman raising children and during the employees temporary incapability to work. There are sanctions for employees for illegal termination and delay with the final settlement. In the case of illegal termination of contract employee has the right to demand reinstatement at the court whereafter the average wages for the period of forced absence will be paid. If the employee waves the reinstatement, he will be paid in Lithuania up to 12 (in Estonia – 6) average monthly wages, and in Latvia the same payments as in case of reinstatement.

*The termination of the contract on the initiative of the employee*

The notice period for unspecified term contract is 1 month in Latvia and Estonia and 14 days in Lithuania. During the probation period it is 3 days in all countries. In Latvia the notice period is not applied if the employee has good cause to terminate relationship. In Lithuania the contract has to be terminated from the day indicated in the employees application in case

[5] Republic of Latvia Labour Code (with amendments to 25 October 1994). Latvian National Labour legislation. International Labour Organization Central and Eastern European Team. [http://natlex.ilo.org/txt/E94LVA01.htm]

of employee illness, disability and more than 30-day lay-off. For specified term contracts the employee has to notice the employer at least 2 weeks in advance (if the contract exceeds a year) or 5 days in advance (if the contract does not exceed one year) in Estonia. In these cases also the compensation has to be paid in the amount 1-4 month wages in Latvia and Estonia and 1-6 month wages in Lithuania. The compensation increases with the length of the employee's record at the employer.

*Resolution of labour disputes*

Individual disputes may be resolved by direct negotiations, labour dispute commissions or at the court. Labour dispute commissions shall consist of representatives of both employer and employee. There are deadlines for applying with the matter to the court: in Lithuania 1 month or within 10 days from the expiration of the time limit on the formation of the commission[6], in Latvia 1 month and in Estonia 4 month. Employees may apply with the matter to the court if that is not settled in the undertaking and in some circumstances also directly (e.g. about reinstatement to work after firing on the initiative of the work). The new Latvian labour law does not anymore specify labour dispute commissions.

*The aggregate indicators of employment protection regulation*

In order to generalize the above information and to compare how strict is the regulation of labour relations across Baltic States and European countries summary indicators were calculated according to the methodology of Nicoletti *et al*. (2000). The index measuring the legal restrictions for individual dismissals shows that in Latvia the dismissals are less regulated than in Estonia and Lithuania. The value of index for the Baltic States is higher than the average of the European Union. On the other hand the usage of fixed term contracts is less restricted in the Baltic States and in Lithuania their usage is less restricted than in Latvia and Estonia. For more information see Appendix 8 and Appendix 9.

[6] Republic of Lithuania Law on Labour Disputes Resolution (20.06. 2000). Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=157735&Condition2=]
Individuaalse töövaidluse lahendamise seadus (1.09.1996).
[http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=16846&akt_id=16846]

## Work in civil service

*The regulation of work in civil service*

The employment of civil servants is regulated with special laws like The State Civil Service Law in Latvia, Law on Public Service in Lithuania and Public Service Act in Estonia[7]. In Estonia and Lithuania public servants are people working in state or local government administrative agency. In Latvia civil servant is a person working in the central apparatus of the government. Employment contracts shall not be concluded with civil servants, so there are differences in working conditions for civil servants and the employees working under employment contract. Civil servants have some advantages, but are also subject to additional duties and obligations. The positions of the civil service are grouped into categories and civil servants are given grades (Lithuania) or qualification categories (Latvia). For instance in Lithuania positions are grouped into 4 categories (from A-D according to the level of minimum required education) and into 30 grades. In Estonia for all public servants there are established 35 salary grades. Higher grades are for higher officials and lower grades are established for unskilled workers in the support stuff.

*Status of people working in civil service*

There are restrictions for who can be in the civil service. These restrictions are similar across the countries and concern citizenship, possession of the official language, education and age. The people in civil service must not be convicted of major rimes, dismissed from the civil service for misconduct (Lithuania) or by court judgement (Latvia), former officers of the USSR State Security Committee, persons under investigation for crime or closely related to an official or to the immediate superior who has direct control over the corresponding office (Estonia and Latvia).

*The arrangement of work-time and wages*

The working period for civil servants is generally unspecified. In Latvia definite term is allowed if the circumstances are indicated; also persons are appointed to the position of the head of an institution for 5 years. Probation period of length up to 6 month in Latvia and in Estonia and 1 year in Lithuania can be applied.

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[7] The Republic of Latvia State Civil Service Law (01.01.2001) Translation and Terminology Centre [http://www.ttc.lv/en/default-translations-lr.htm]
The Republic of Lithuania Law on Public Service (08.06. 1999). [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=94580&Condition2=]
Avaliku teenistuse seadus (01.01.1996).[ http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=13738&akt_id=13738]

The basic monthly salary is paid in Lithuania for the grade of the servant and in Latvia for the qualification category and level of position. Supplements are for additional duties and increased work intensity in Latvia, work on holidays, in harmful conditions and for performing duties beyond their normal working conditions in Lithuania (in Lithuania: not more than 50 % of base salary). In Lithuania there is also seniority bonus for the years in public service (3 % of the basic salary for every 3 years but not more than 30 % in total ). In Lithuania persons on probation shall receive a salary that is 70% of the basic salary of the position held and they shall not receive bonuses. In Estonia higher grades are for higher officials and lower grades are established for unskilled workers in the support stuff. The established salary rate may exceed the rate set by the government in the amount 50% and the differentiation of salaries must be done according to qualification requirements, working conditions, region etc.

*Holidays and vacations*

Civil servants are granted annual leave of 4 weeks in Latvia and Lithuania (in Estonia 35 calendar days). For holiday period average wage is granted to the employee. In Estonia also there might be paid the holiday benefit of up to 1 month's salary. In Lithuania civil servants with more than 5 years of employment are granted additional 3 days for each 3 years of subsequent employment, but the additional vacation may not be longer than 14 calendar days. In Estonia 1 additional vacation day is given for the third and every additional year of service, but not more than 10 days total of additional vacation is given.

In Latvia civil servant has the opportunity to improve qualification for not less than 45 days within a 3-year period with retaining salary. Half of the tuition fee shall be covered for a civil servant who studies at an educational institution in order to acquire the knowledge required for his position. Study leave not more than 20 working days with retention of salary is granted. Also leave without pay may be granted. In Estonia public servant has right once in 5 years to the study leave of up to 3 month with pay for professional development.

*Additional rights of civil servants*

In Lithuania public servants have rights to training and improvement of professional qualification financed from the state, municipal etc. budgets. They shall be paid in addition to state social insurance pension also the state pension on civil servants under the Law on Civil Servants' Pensions. In Estonia servants have right to additional state old-age pensions (e.g. for over 30 years of service the pension is increased by 50%).

Civil servants receive special benefits in case of death and work accident. In Estonia public servants are entitled to forgiveness of the state educational loan, after graduating from educational institution (every year of the service is repaid 1/5 of the loan). The person studying at the state university, whose at least one parent is or was working in public service at least 15 years, has right to reimbursement of tuition fees.

In Latvia the same rules apply to termination of service relationship with the official except that allowance of 1 month's salary is paid when service relations are terminated with the liquidation of an institution or reduction in the number of servants. In Lithuania career civil servants with a record of uninterrupted employment in the service no less than 2 years may leave the service for up to 3 years with the right of having their status re-established. In Estonia unemployed civil servants have during the first 6 month of unemployment right to be listed in the reserve of officials; vacant positions are fulfilled in the first order with an official from the reserve.

*Restrictions for public servants and their duties*

In Latvia civil servants 1) may work elsewhere only with written permission from a higher public official[8]; 2) are responsible for lawfulness of ones' actions or failure to act 3) have duty to improve their qualifications. In Lithuania civil servants must not 1) be the members of management bodies of enterprises, 2) be an employee in private enterprises, 3) hold more than one position in public service, 4) enter into contracts on behalf of the institution at where he/she is employed with enterprises where he/she is an owner. In Estonia there are restrictions for civil servants concerning membership in political parties and commercial associations and additional work with another employer (it is allowed only if they have consent of their superior).

*Settlement of disputes*

Settlement of disputes is determined in Latvia with Law on Disciplinary Sanctions for Civil Servants and in Lithuanian with Law on Public Service. In Lithuania disciplinary sanctions are applied for misconduct in office. More severe sanctions are imposed for wilful misconduct than for misconduct through negligence. In Estonia officials have the right to apply within 1 month to the administrative court against orders, directives and resolutions issued, and acts

[8] The Republic of Latvia Prevention of Corruption Law (21.12. 1995, with amendments to 18.03.99) Translation and Terminology Centre [http://www.ttc.lv/en/default-translations-lr.htm]

performed concerning service-related issues; the disciplinary offences and their processing in civil service are the same as in working under the employment contract.

**Legal Regulation of the Unemployed**

The regulation of the status of the unemployed is in all countries regulated with special laws[9]. The status of the unemployed is acquired if person 1) is at working age, 2) is not working nor studying, 3) is looking for job, 4) have registered at the state employment agency. In Estonia the person must also have the employment record of at least 180 days during the 12 preceding months. The 60-day waiting period before receiving unemployment benefits is applied to persons who have studied, resigned from their last job of their own free will, been dismissed due to violation of a labour contract etc. The person can be registered as unemployed 270 days in Estonia.

The list of rights of the unemployed people includes the 1) receipt of unemployment benefits, 2) the vocational training (in Lithuania and Estonia with training allowance), 3) right to participate in paid public works, 4) free labour exchange services in looking for job. In Estonia unemployed have right to get a subsidy to start a business. In Lithuania vocational training is also available to employed persons who must change qualification or starting own business. The additional qualifying conditions for unemployment benefit include in Latvia 9 month of insurance and income lower than minimum wage and in Lithuania at least 24-month insurance record within last 3 years (unless it lacks for valid reasons) or placement by labour exchange on public works or completed vocational training no less than 180 days.

The calculation of benefits is different in three countries. In Latvia these are determined according to the length of service and of unemployment: 1-5 years of service, 50% of the salary of the last 6 months, for 5-15 years, 55%; 15-25 years, 60%; over 25 years, 65%. Full amount is paid for the first 3 months, 80% for 3-6 months, and 60 % for 6-9 months. Minimum benefit is 90% of minimum wage. In Lithuania unemployment benefit is calculated from formula that considers along with state supported income and minimum livings standard also the length of the individuals insurance. The maximum duration of the payment

[9] Republic of Lithuania Law on Support of the Unemployed (15.01.1998) Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=56458&Condition2=]
Republic of Lithuania Law on Vocational Education and Training (07.07.1999). Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=123796&Condition2=]
Töötu sotsiaalse kaitse seadus (01.01.1995 ).
[http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=36821&akt_id=36821]

is 6 month within 12-month period. In Estonia state unemployment benefit is fixed – 400 EEK per month but in addition the unemployment insurance was introduced in 2001.

The first payment will be done from January 2003. In order to get insurance payment person should be working 12 month during last 24 month. Both sides will do contributions to Unemployment Insurance Fund, worker 1% from his salary and employer 0,5% from total payroll. The payment period of benefit depends on insurance tenure, if person has insurance less than 5 years, then payment period is 180 days, with tenure 5-10 270 days and with tenure more that 10 years maximum payment period is 360 days. The size of insurance payment depends on previous average salary. First 100 days person is entitled to get 50% from his/her previous average daily salary, and rest of the period he/she gets 40%. Upper limit of monthly payment is 50% from triple national average wage. For instance, if national average before tax salary is 5500 EEK, then maximum unemployment benefit is 50%·(3·5500)=8250 EEK. During the period when person is entitled to get unemployment insurance payment, he/she has no right to get state unemployment benefit.

The unemployed have duties like 1) to look for a job, 2) to attend state employment service, 3) attend active labour market measures. Additional guarantees are available to certain groups of people (persons under 16, women with children, persons within 5 years to become eligible for old-aged pension). For instance in Lithuania to provide such individuals with work employment quotas may be prescribed for employers of up to 5 % of the total number of employees.

**Generalization**

The regulation of employment relations corresponds to international standards due to protection of employees' rights in relevant issues. In Lithuania the legal regulation has more adverse impact on labour market flexibility than in Latvia: higher minimum wage, longer advance notice period and bigger firing compensations. The summary indicators of legislation according to methodology of Nicoletti (2000) showed that in Latvia the dismissals are less regulated than in Estonia and Lithuania. The value of index for the Baltic States is higher than the average of the European Union. On the other hand the usage of fixed term contracts is less restricted in the Baltic States and in Lithuania their usage is less restricted than in Latvia and Estonia. As separate laws regulate the status of civil servants, they have some advantages, but are also subject to additional duties. The status of the unemployed people is regulated and

they are subject to several rights. In Lithuania the unemployed people enjoy higher unemployment benefits and the conditions for getting these are less stringent than in Latvia.

## 4.2. The role of trade unions

The role of trade unions in Central and East European countries (CEE) is discussed in this part. The aim is to give the overview of trade unions in CEE countries concentrating especially on trade union developments in the Baltic States. The union membership, collective bargaining levels and coverage of collective agreements is discussed.

*Union density*

In most western and northern European countries trade unions have a great role in wage determination. Even when the number of unionised workers is low, collective agreements are usually extended to non-unionised workers. In Central and East European countries the role of trade unions is less important.

Central and Eastern European countries are rather homogeneous in terms of wage bargaining coordination and the role of trade unions. The importance of trade unions[10] has been decreasing in all the CEE countries since 80's. While in the end of 80s the whole labour force belonged to the trade union, then by the middle of 90's the number had dropped to 30 to 60 percent. In the end of 90's trade union density was less than 35% in all the transition countries except Slovenia. Trade unions in the Baltic States are more common in the public sector, in healthcare and education.

**Table 1 Union density**

| Country | Union density | |
|---|---|---|
| | 1995 (1) | 1996-2001 |
| **Slovenia** | 60.0 | 63.5 (2) |
| **Slovakia** | 61.7 | 35 (3) |
| **Czech Republic** | 42.8 | 30 (4) |
| **Latvia** | 30 | 25 (5) |
| **Lithuania** | 40 | 15 (5) |
| **Estonia** | 36.1 | 12 (5) |

Source: (1) – Riboud *et al*. 2002; (2) – Vodovnik 1999; (3) – Joint Assessment of Employment Policy Priorities in the Slovak Republic 2001; (4) Vaughan, Whitehead 1998; (5) Antila, Ylostalo 1999.

In the following part the role of unions in the Baltic States at the national level is discussed.

[10] The importance of unions is measured in union density and union coverage. Union density is the number of salaried workers belonging to the trade union. Union coverage is defined as the collective agreement coverage of salaried workers.

*Unions in Latvia*

The organising rate in Latvia is higher than in Estonia and Lithuania. One fourth of Latvia's 800 000 employees have joined the unions. (Latvia's only central trade union organisation is LBAS – Latvijas Brivo Arodbiedribu Savieniba.) The organising rate in the public sector is higher than in the private sector. 60 % of the organised labour forces are women. The teachers' union is the largest union, followed by the two health sector unions. The main sectors with trade union membership are health care, education, transport, communication, public services, agriculture, food and fishery, industry, energy and construction.

Although union membership fell sharply in Latvia in the 90s, this trend has recently come to an end for practical purposes. The decrease resulted mainly from the splitting up and privatisation of large state enterprises and collective farms. In Latvia there is a new mood of optimism among young people joining the unions. About 12 % of the membership are under 25 years of age (Antila, Ylostalo 1999).

*Unions in Lithuania*

Lithuania has 4 central trade union organisations with the total membership of about 10-15 percent of the employed persons. These four organisations are not cooperative and are keeping their distance. Lithuanian Free Trade Union Confederation is the largest trade union association. The main sectors where trade unions are active are healthcare, transportation, construction, railway, agriculture, trade, education and civil service. Trade unions do not exist in the small enterprises, as in all the other Baltic States.

*Unions in Estonia*

There are three central trade union organisations in Estonia. The EAKL, which organises both workers and salaried employees, has about 80,000 members. TALO concentrates its organising efforts on salaried employees. It has some 50,000 members. ETMAKL consists of food industry and agriculture sector workers and has about 10 000 members. There are more trade unions in public sector. The largest unions are in industry, energetics and transportation. There are some sectors where unions are missing, for example banking and construction and services.

In Estonia unions exist more in the sectors with women workforce, which leads to the larger share of women in union membership. There are older workers in the unions, the average union member is 40 years old.

In conclusion the trade unions in CEE countries are rather small when measured in union membership. In the Baltic States the trade union density is even smaller compared with other CEE countries. In the following part trade unions are analysed by their coverage and the levels of collective agreements.

*Wage bargaining levels and coverage of collective agreements*

Even more important than the number of unionised workers is the coverage of collective agreements. In Western European countries union coverage is usually much larger than the actual number of union members. Collective agreements are usually enlarged to the whole workforce. In most CEE countries enterprise level collective agreements are also enlarged to the whole workforce of the company. For example, in Romania sectoral-level agreement automatically enlarges to the whole workforce of the company. In Poland if the parties do not agree on anything else then the agreement automatically enlarges. If it is found to be necessary for social welfare then labour ministry in Poland may force the agreement for the whole workforce. Similarly in Hungary Labour Ministry has the right to enlarge the agreement to the whole workforce in the sector if the union is representative in the sector. (Casale 1997)

The surprising evidence from transition countries shows that coverage of collective agreements is usually not much higher than the union membership. The result is partly due to the missing data of collective agreements. In most transition countries collective agreements are not registered. The other reason for low collective agreements coverage is the small number of sectoral level agreements. The levels of collective bargaining in CEE countries are discussed in the following part.

In CEE countries collective agreements are more common at enterprise level or national level. At sectoral or regional level the bargaining process is less developed (Casale 1997). At national level in most of the CEE countries the minimum wage is decided (Casale 1999). The popularity of the national level wage bargaining is probably caused by the traditional coordinative role of government. The larger scale of enterprise level bargaining compared to sectoral level is due to the less organised employers.

*The state or national level bargaining*

Transition countries introduced the national level bargaining already in the beginning or transition process. National level bargaining takes place mainly in tripartite bodies, which include members from government, employers and unions. One of the main tasks of national

level bargaining is to decide the level of minimum wage. Other questions in the bargaining have been reforms of labour market legislation, social reforms and pensions. Still the importance of unions even in national level bargaining is rather low and the main function of tripartite bodies is consultative.

*The regional level bargaining*

Regional level bargaining is not developed in most of the transition economies including the Baltic States. Sill, there are some exceptions (i.e. Poland). In general social partners in the Baltic States have weak regional structure, in some cases there are no local organisations. One of the main reasons for the lack of regional level bargaining in the Baltic States is the small geographical unit, which are much smaller than for example in Poland.

*The sectoral or branch level bargaining*

Sectoral level bargaining is also rather rare in transition economies. According to estimations sectoral level agreements cover about 10-17% of the workers in the Baltic States and from 6 to 30 percent in all the CEE countries. The idea of the sectoral level agreements is usually to provide minimum standards. In some cases they are only wage agreements, which fix minimum wage in the sector. As was mentioned the main problem in the sectoral level bargaining are the weak employer associations. It has been noted that trade unions have been helping to establish employer federations in branch level to have the social partner in the negotiations. It is expected that sectoral level bargaining will develop more when the employers will organise themselves.

Most of the sectoral level bargaining takes place in the public sector. For example Latvia has sectoral agreements covering sectors such as energy, nursing and health-care, construction, education, culture, forestry, food industry, commerce and fishing. In Lithuania the sectoral level agreements are least developed in the Baltic States. There are only a few examples of sectoral agreements in Lithuania (compared to 26 agreements in Latvia and 13 in Estonia in 2000) for example the agreement in telecommunication industry (Due, Mailand 2001).

*The enterprise level bargaining*

Besides the national level agreements, enterprise level agreements are the most common in CEE countries. Still in all the CEE countries employers are not interested in concluding the collective agreements. The initiative to bargain is usually taken by the trade unions. Employers are under legal obligation to conclude the agreement if the employees wish to do

so, but in practice there are often disputes where employers attempt to avoid signing agreements.

Most of the enterprise level agreements are concluded in the public sector, in large public sector enterprises or in privatised enterprises. Enterprise level bargaining is remarkably less developed in foreign companies (Due, Mailand 2001).

The estimates of enterprise level agreements' coverage in the Baltic States vary. The estimates are presented in the following part:

- Estimates of the coverage of collective agreements at the enterprise level in Estonia vary. According to Due and Mailand (2001) the coverage of collective agreements is from 6-14%. According to the data from the largest union – about 14 % of the workers was covered by collective agreements in year 2000.
- In Latvia Due and Mailand (2001) report the coverage to be 10-30 %, while the rate of unionisation 10-40%. Antila and Ylöstalo (1999) report that Latvia is the Baltic country with the highest rate of unionisation 25 %.
- In Lithuania Due and Mailand (2001) report the coverage to be 10-30%. While Antila and Ylöstalo (1999) report the number of unionisation to be 15%.

It can be concluded that trade unions in Central and East European countries are rather small in both the union density and collective agreements coverage. Collective agreements are more common at enterprise level or national level. At sectoral or regional level the bargaining process is less developed. Still can be concluded that most employees in CEE countries rely on individual employment contracts. The reasons for the small importance of unions in the transition economies have usually been found in the following.

- Trade unions are not well organised, which could lead to a situation where several unions with different aims enter the bargaining process.
- Weak position of unions.
- Weak employer associations.
- Large share of small enterprises.
- Employers' preference to bargain only at the company level.
- No enforcement of sectoral level agreements.

## 4.3. Labour market policy

Public spending on labour market programmes absorbs significant shares of national resources in most EU member and candidate countries. For analytical purposes, the spending is split into so-called "active" and "passive" measures. The former comprise a wide range of policies aimed at improving the access of the unemployed to the labour market and jobs, job-related skills and the functioning of the labour market while the latter relate to spending on income transfers. In the first sections an overview of labour policy instruments and implementation in three Baltic States is given. In the final section, the three states are compared, assessed and some conclusions are drawn.

### Estonia

In Estonia, the expenditures on labour market policies accounted for 0,22 % of GDP in 2001. The state allocations for labour market measures have been increasing constantly. Major share of such an increase has been used to fund the increasing need for benefits. As a result, the share of passive measures in the overall employment policy budget has increased substantially since 1995. In 2001, only 28% of the total expenditures on labour market measures were spent on active measures. The dynamics of labour market expenditures in Estonia are given in below.

**Table 2 Expenditures on labour market policies in Estonia, 1995-2001**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **Total expenditures (mil. EEK; 1+2+3)** | 67,5 | 87,7 | 105,9 | 114,6 | 184,3 | 185,5 | 208,5 |
| Per cent of GDP | 0.17 | 0.17 | 0.16 | 0.16 | 0,24 | 0,22 | 0,22 |
| Share of total expenditures (%) | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **1.Public employment services and administration** | 18,9 | 15,5 | 14.5 | 16.5 | 9,0 | 9,6 | 10,0 |
| **2. Passive Employment Policy** | 40,5 | 44,8 | 47.3 | 49.9 | 65,3 | 63,8 | 61,5 |
| Unemployment benefits | 40,5 | 44,8 | 47.3 | 49.9 | 65,3 | 63,8 | 61,5 |
| **3. Active Employment Policy** | 40,5 | 39,7 | 38,3 | 33,5 | 25,7 | 26,6 | 28,0 |
| Labour market training | 26,0 | 26,3 | 26.4 | 24.2 | 17,4 | 17,5 | 20,5 |
| Training allowances | 7,0 | 5,7 | 5.1 | 3.6 | 3,3 | 3,5 | 3,7 |
| Subsidy to employer | 0,5 | 0,9 | 0.9 | 0.9 | 1,0 | 1,2 | 1,7 |
| Subsidy to start a business | 5,4 | 4,3 | 3.7 | 3.2 | 2,3 | 2,6 | 2,2 |
| Community placement | 1,6 | 2,5 | 2.2 | 1.6 | 1,8 | 1,8 | - |

Source: Estonian Labour Market Board

The main passive measures used in Estonia – unemployment benefit and newly introduced unemployment insurance - were already described in the chapter of labour market regulations. The rate of unemployment benefit is currently so small in Estonia that a person who has lost job has to apply for subsistence benefit as well. Thus the unemployment benefit fails to fulfil

its function in smoothing consumption during the unemployment period of the household members. The new unemployment insurance system eliminates the need for people eligible to unemployment insurance benefit to apply additionally to subsistence benefit but it does not change the situation for people receiving state unemployment assistance. The replacement rate[11] is low in Estonia: it is 27% for a couple without children, 33% for a single person and 39% for a couple with two children and 48% for a single parent with two children. On the other hand it appears that in spite of that in various cases it is more beneficial to live on benefits than start working for a minimum wage. The duration of the subsistence benefit is not limited. It is stated to decrease the motivation to search for work more than benefits with higher level but with certain termination date practised by other countries. It is also notwithstanding that at the same time when most of the EU countries tighten up on eligibility conditions for receipt of benefits, in Estonia the criteria have been relaxed. In order to decrease the negative effects of the benefit system on work incentives, it is proposed by different experts to make the eligibility criteria for unemployment benefits stricter and place stronger emphasis on the elements that would encourage people to search for work.[12]

Currently, the following active labour market measures are implemented:

a) public employment services and administration,
b) employment training and allowances,
c) subsidised employment (subsidy to start a business, subsidy for employers to employ persons who are less competitive in the labour market, community placements).

The most important active measure in terms of participants and expenditure is labour market training. In 2001, expenditure on training accounted for 20,5% of the total budget followed by expenditure on administration of state employment offices (10%), training allowances (3,7 %), business start-up subsidies (2,2%) and subsidies to employers (1,7%).

The participation on active programmes is relatively low and has decreased since 1995 (see Appendix 10). In 2001, only 8,2% of registered job-seekers participated in active labour market measures while in accordance to the European Union employment guidelines the goal is the 20% of unemployed. An increased role for active labour market policies is therefore an important priority of the Estonian labour market policy. The *Employment Action Plan 2002* includes a number of new initiatives with the aim to tackle the long-term unemployment. Due to short track record, the results are not apparent yet.

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[11] Replacement rate is the standard indicator of the generosity of an unemployment benefit system, *i.e.* the proportion of expected income from work that is replaced by unemployment and related welfare benefits.
[12] Kuddo *et al.* 2002, p. 85.

According to recent evaluations, one of the main problems is poor targeting of the programmes.[13] Given the limited resources available, it will be important to ensure that these programmes remain targeted on the most disadvantaged job-seekers and regions and that their impact is closely monitored. One specific example is aid to starting business. Experience elsewhere suggests that this form of subsidy appears to be successful but only for a small group of unemployed individuals. Currently, there are different support structures implementing this kind of measures in Estonia. In addition to Labour Market Board, the business support structures under the governance of the Ministry of Economic Affairs offer start-up aid for beginning entrepreneurs. There is a need for closer inter-ministerial co-ordination in this field as well as for more efficient combining of the subsidy with relevant training and consultancy.

**Latvia**

In Latvia, the expenditures on labour market policies accounted for 0,64 % of GDP in 2001. The state allocations for labour market measures have been volatile. Expenditure on passive measures has increased considerably and take the majority of the total expenditure. As a result, the share of passive measures in the overall employment policy budget has increased substantially since 1995. In 2001, only 22% of the total expenditures on labour market measures were spent on active measures. The size of the expenditure on passive measures is remarkable in comparison to Estonia (0.42-0.86 per cent of GDP), that is due to the high size of the average unemployment benefit (in year 2000 45.30 LVL or 160 EUR). The dynamics of labour market expenditures in Latvia are given in the table below.

The size of unemployment benefit in Latvia depends on the length of the person's previous employment record (see also the section on regulations). For those receiving the average wage in the economy it was equivalent to about 40% of the net after-tax earnings. However, the replacement rate in the early months of unemployment can be significantly higher than this average rate. Indeed, the replacement rate is higher for those who previously had above-average earnings. While replacement rates fall relatively sharply as the duration of unemployment increases, these initial rates appear sufficiently high to create disincentives for persons in the early stages of unemployment to consider job-offers offering wages even marginally lower than their previous earnings level.[14]

[13] Joint Assessment of Employment Priorities in Estonia. 2001, Tööturupoliitika planeerimine ..., p. 5-11.
[14] Joint Assessment of Employment Priorities in Latvia. Draft, 2002.

Actually, only a minority of the registered unemployed receives benefit. In the year 2000, the average number of benefit recipients was approximately ¼ of the unemployed. Registered unemployed people who are not entitled to unemployment benefit can apply to their municipality for social assistance benefits. Social assistance benefits are designed "to provide social security and protection for those who are not able to provide for themselves or to overcome specific difficulties in life and do not receive adequate assistance from other sources", and unemployed people therefore appear to qualify. However it appears that few of them do so – it has been estimated that only 2% of households who have unemployed members are actually in receipt of social assistance. It could be concluded that the overall coverage of the unemployed by the system of income maintenance is relatively low.

Total expenditure on active labour market policy was 0,16% of GDP in 2000. There are three main active labour market programmes:

- Vocational training, retraining and upgrading of qualifications for the unemployed
- Temporary Public Works (TPW) are organised with the aim of helping unemployed people who want to work, but who, for various reasons, cannot find a suitable permanent job. During participation in TPW, the minimum wage is paid by the state, and the employer pays the social insurance contributions.
- Job-seekers' clubs (JSC) are an active measure for social– psychological rehabilitation, which aims to stimulate the initiative of unemployed people, raise their ability to re-orient and adapt psychologically to a new market situation, improve their readiness to meet the needs of the labour market, and promote contact and dialogue between employers and job seekers.

According to the expenditures (see Table 3), the most important active measure is professional training (60%), followed by public works (36%) and job clubs (4%). During the passed four years, the proportions have not changed. In terms of participation, the job club activities are of the major importance: 49,2 % of the unemployed involved in active employment measures participated in job clubs. 20,5% were sent to training and 30,3% to temporary public works[15].

[15] Analysis of unemployment situation in Latvia in 2001. State Employment Service. Latvia, 2002.

**Table 3. Expenditures on labour market programmes in Latvia, 1998-2001**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **Total expenditure on active and passive measures** | - | - | - | 25.98 | 40.92 | 33.03 | 30.33 |
| Per cent of GDP | - | - | - | 0.72% | 1.05% | 0.76% | 0.64% |
| **Passive measures (insurance against unemployment (mio of LVL))** | 10.40 | 11.80 | 14.30 | 19.70 | 33.60 | 26.60 | 23.68 |
| Per cent of GDP | 0.44% | 0.42% | 0.44% | 0.55% | 0.86% | 0.61% | 0.50% |
| Unemployment benefits (% of passive measures) | 73.1% | 79.7% | 79.7% | 74.6% | 81.8% | 80.8% | 77.7% |
| Unemployment grants (% of passive measures) | 1.9% | 2.5% | 2.8% | 3.6% | 2.4% | 2.3% | 3.4% |
| Other expenditures (% of passive measures) | 25.0% | 17.8% | 17.5% | 21.8% | 15.8% | 16.9% | 18.9% |
| **Total budget on active programs (mio of LVL)** | - | - | - | 6.28 | 7.32 | 6.43 | 6.65 |
| Per cent of GDP | - | - | - | 0.17% | 0.19% | 0.15% | 0.14% |
| Public works (% of active measures) | - | - | - | 34% | 31% | 33% | 36% |
| Professional training for unemployed (% of active measures) | - | - | - | 62% | 65% | 62% | 60% |
| Job clubs (% of active measures) | - | - | - | 4% | 4% | 5% | 4% |

Source: State Employment Service; Ministry of Welfare (Social Report 2001).

As regards to the organisation of active labour market programmes, priority of involvement is given to people from disadvantaged groups such as: disabled people, youngsters, long-term unemployed, non-Latvian speakers and pre-retirement age people. In 2000 average participation in training and temporary work programmes combined was just over 4% of the average number of unemployed. It is recognised that there is insufficient access to active programmes, particularly for the young and for the long-term unemployed. For example, in 2000, training opportunities could be provided for only 36,6% of the unemployed people who expressed a desire to acquire a new profession or to upgrade qualifications. Increasing access to active programmes is included among the objectives of the *National Employment Plan 2001*. However, expansion of active programmes is constrained by the availability of budgetary resources.

## Lithuania

Total expenditures on labour market measure policies account for 0,27 % of GDP in Lithuania being slightly over the respective number in Estonia. The passive measures (41,0%) dominate over the active (34,1%). The share of expenditures on labour market institutions is 24,5%, well above the respective number of Estonia.

**Table 4 Expenditures on labour market policies in Lithuania, 1995-2001**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **Total expenditures (in thousands, LT)** | 70 830 | 101 813 | 114 217 | 150 601 | 151 596 | 158 828 | 174 382 |
| ***% of GDP*** | - | - | - | 0.25 | 0.27 | 0.27 | 0.27 |
| **Expenditures on passive measures, % of GDP** | - | - | - | 0.12 | 0.14 | 0.18 | 0.15 |
| **Expenditures on active measures, % of GDP** | - | - | - | 0.13 | 0.13 | 0.09 | 0.12 |
| **Share of expenditures (1+2+3)** | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| **1. Financing of passive measures (unemployment benefits)** | 46,4 | 509 | 42,9 | 33,7 | 40,0 | 50,7 | 41,0 |
| **2. Labour market institutions** | 23,1 | 21,3 | 21,4 | 28,3 | 23,6 | 24,5 | 24,5 |
| **3. Financing of active measures** | 28,1 | 27,4 | 35,4 | 37,5 | 36,2 | 24,6 | 34,1 |
| *Retention of jobs* | | 0,1 | 0,2 | 0,3 | 0,6 | 0,7 | 0,7 |
| *Vocational training* | 19,6 | 17,3 | 18,5 | 18,2 | 18,9 | 10,8 | 14,4 |
| *Public works* | 2,9 | 4,0 | 4,8 | 8,2 | 9,5 | 8,4 | 11,5 |
| *Start of own business* | 2,2 | 0,8 | 0,5 | 0,3 | 0,1 | 0,1 | 0,2 |
| *Support of employment* | 3,4 | 5,3 | 11,3 | 10,4 | 7,0 | 4,1 | 6,2 |

Source: Ministry of Social Security and Labour.

Registered unemployed persons are entitled to unemployment benefit if they have worked and paid social contributions for least 24 months during the last 3 years. Unemployment benefit is payable for a period of 6 months. The monthly rate of payment varies according to the length of previous insured employment (from a minimum of LTL 135 up to a maximum of LTL 250). People on low incomes can also apply to their municipality for social assistance. Access to all aspects of social assistance requires that the recipient, if able-bodied and of working age, should be registered as unemployed. Data are not available, however, on what proportion of the registered unemployed actually receive social assistance. Generally, coverage of the unemployed by income-support measures appears relatively low in Lithuania.

In general, moreover, the rates of payment are low relative to net earnings when in employment. There are, however, some instances where people on social assistance could face disincentives to moving into employment. For example, a person with one adult and two depending children receiving the maximum level of social assistance would have an income equivalent to over 70% of the net income he/she would receive if earning the average wage. The rate exceeds considerably the respective rate of Estonia (48%) and reaches the average level of EU member states. This "replacement rate" would obviously be higher if the person concerned were lower skilled and thus likely to find employment only at below-average

earnings. Replacement rates for young single people are significantly lower – not exceeding 50% even for someone considering taking a job at the minimum wage[16].

Total expenditure on active labour market programmes was 0,12% of GDP in 2001. The following active measures are implemented:

- re-training for the unemployed,
- provision of temporary public works jobs,
- recruitment subsidies for private employers,
- provision of support for "job clubs" (these involve short-duration training in job-search techniques. The main focus is on changing the attitudes of the trainees and motivating them to search actively for employment and to consider other options such as self-employment).

Out of the total expenditure 46% was used for retraining programmes, 34% for temporary public works, 17% for employment subsidies, and 1% for job clubs. The balance within programmes is concentrated on the provision of temporary jobs, which accounts for one-third of total programme expenditure, and for an even higher proportion of the average number of programme participants (see Appendix 10).

Programme expenditure and participation are extremely low relative to the scale of Lithuania's unemployment problem. The average number of participants on programmes in 2000 (excluding job clubs) is estimated at no higher than 3% of the average number of registered unemployed. The demand for places, particularly in vocational training, greatly exceeds supply.

**Assessment**

Compared to the EU, labour market policy is rather insufficiently funded in all Baltic States. The expenditures on labour market measure policies account for 0,22 % of GDP in Estonia, 0,64 % in Latvia and 0,27% in Lithuania in 2001. This is a very small fraction compared to the respective average rate of 2,48% in the EU or even the respective rate in selected EU candidate countries (see table below).

[16] Joint Assessment of Employment Priorities in Lithuania. 2002.

**Table 5 Spending on labour market programmes in the EU and selected candidate countries**

| | Total spending (as % GDP) | Active spending (as % of GDP) | Active spending (as % of total spending) |
|---|---|---|---|
| **Estonia** | 0,22 | 0,06 | 28,0 |
| **Latvia** | 0,76 | 0,15 | 22,0 |
| **Lithuania** | 0,27 | 0,12 | 34,1 |
| **Czech Republic** | 0,52 | 0,22 | 42,9 |
| **Hungary** | 0,87 | 0,39 | 45,3 |
| **Poland** | 2,25 | 0,54 | 24,0 |
| **EU** | 2,48 | 1,12 | 39,8 |

Sources: Martin et al, p. 7, Estonian Labour Market Board, Ministry of Social Security and Labour of the Republic of Lithuania, Joint Assessment of Employment Priorities in Latvia (draft).

Secondly, the share of active measures is relatively low in both expenditures and participation rates. In Lithuania 34,1%, in Latvia 22% and in Estonia 28% of the overall employment policy budget is allocated on active measures while the EU average is almost 40%. At the same time, the overall coverage of the unemployed by the system of income maintenance is still low in all three states.

Replacement rates are low in comparison with the 60% in the EU member states. Slight differences among the Baltic States could be pointed out: the replacement rate is lower in Estonia and Latvia and higher in Lithuania where it amounts to the EU average in certain cases. Still, it could be noted that in all of the three states the income maintenance system have to a certain extent dampened the incentives to look for a job. The influence is still minor if to compare with the well-developed European countries where the replacement rates are sufficiently large to have significant effects on work incentives and consequently on labour flexibility. However, given the political conditions, only marginal cuts have been made in the generosity of benefit entitlements. Rather the eligibility conditions for receipt of benefits are tightening up and activation strategies for the unemployed are developed. The Baltic States have the same path ahead of them.

Currently, participation of registered job-seekers in active labour market measures is insufficient. In accordance to the European Union employment guidelines the goal is to achieve the involvement rate of 20% unemployed[17]. At the moment, the respective number is highest in Estonia - 10%, followed by 4% in Latvia and 3% in Lithuania. It is not clear, if

[17] Draft Joint Employment Report 2001. Council of the European Union, 2001.

recruitment to programmes is appropriately targeted. The groups covered are not necessarily those to which greatest priority should be given in the light of changing labour market circumstances.

Apparently, there is a need for comprehensive analytical evidence on the effects of the existing programmes. This kind of essential knowledge would serve as a basis for developing well-targeted and successful programmes.

It could be concluded that because of the deficit financing of the labour market policy, the unemployment benefits are low and in this way do not decrease remarkably the labour flexibility. On the other hand, through placing a stronger emphasis on active labour market programmes, the positive impact of labour policy on labour flexibility could be increased. In this context, more attention should be paid on education and training, including development of lifelong learning which is now an established priority throughout the EU. At the moment, for example in Lithuania as well as in Latvia, the balance within active programmes is over-concentrated on the provision of temporary jobs but short periods of temporary employment are unlikely to contribute to the longer-term employability of participants.

# 5. Wage flexibility

Wage flexibility shows how the wages react to the recessions and growth in economy. It shows if wages are rigid only downwards or if the long-term wage agreements also slow down the wage rise. The more quickly the wages react to the changes in economy, the more flexible the labour market is. Here we try to measure the flexibility of nominal wages. Usually the flexibility of real wages is treated in literature. In our opinion the fluctuation of nominal wages during business cycle is even better evidence of wage flexibility then the changes in real wage.

Speaking about the wage flexibility in Baltic States, first the economic background has to be discussed. The GDP growth in Baltic States over the period 1995-2000 is presented in the table below.

**Table 6 Gross domestic product (GDP) at constant prices, % compared to previous year**

| Country | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| **Estonia** | 4,3 | 3,9 | 10,6 | 4,7 | -1,1 | 6,4 |
| **Latvia** | -0,8 | 3,3 | 8,6 | 3,9 | 1,1 | 6,6 |
| **Lithuania** | 3,3 | 4,7 | 7,3 | 5,1 | -3,9 | 2,9 |

Source: Statistical Offices of three Baltic States

It can be seen that in 1999 a remarkable fall in GDP growth has taken place in the case of all three countries because of the crisis in Russia at the end of 1998. The fall was largest in the case of Lithuania and the smallest in the case of Latvia because Lithuanian economy is more tied to Russian economy than the other two countries' economies – Estonian export to Russia was in 1998 13,4% of GDP, Lithuanian export to Russia was 16,5% of GDP. In 1999 the shares were in Estonia 9,2%, in Lithuania 7%. In Latvia these numbers were smaller. As the growth rate of GDP has fallen, too, it should be the consequence of changes in different sectors.

In the figure below it can be seen that highest wages in Baltic States are in financial intermediation and public administration sector, at the same time the lowest wages are in all three countries in agriculture and hotels-restaurants sector. It seems that the wage level structure is quite similar in all three countries, although some small differences remain. Estonian and Latvian wage level structure is quite similar, Lithuanian case differs more.

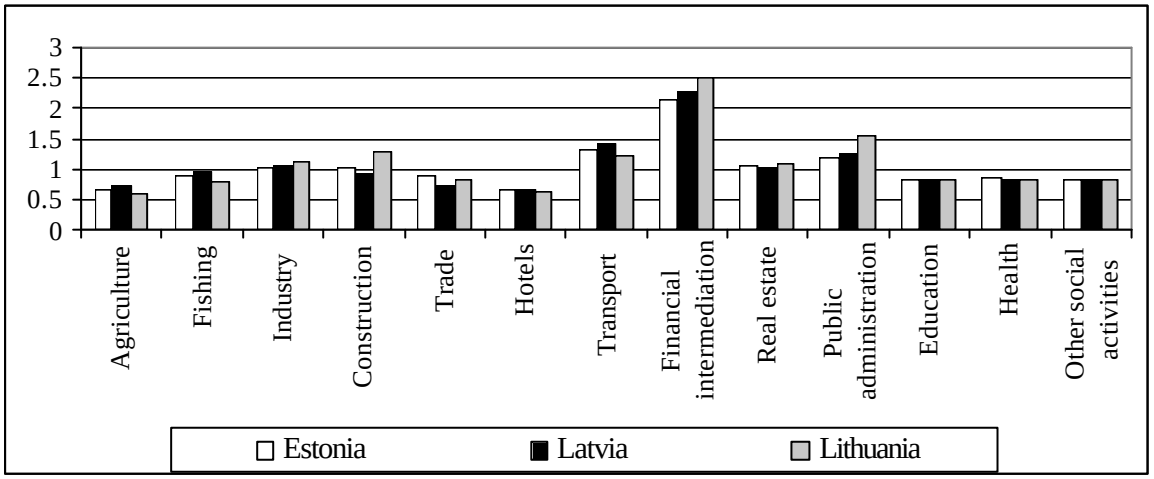


**Figure 7 Shares of wages from total average by economic sectors in Estonia, Latvia and Lithuania[18].**

[18] Average gross and net monthly wages and salaries by kind of activity, 2002. Monthly Bulletin of Latvian Statistics 1(92)/2002, Central Statistical Bureau of Latvia, Riga, p. 61
Average gross and net monthly wages and salaries by kind of activity. Statistical Yearbook of Latvia 1997, 1998, 1999, 2000. Riga, Statistical Office of Latvia.
Average monthly gross earnings in the whole economy by economic activity, 2001. Statistical Yearbook of Lithuania, Statistics Lithuania, Vilnius, p. 238
Average monthly gross wages (salaries) by economic activity indicator and year, [http://gatekeeper.stat.ee:8000/px-web.2001/Dialog/Saveshow.asp] 28.05.2002

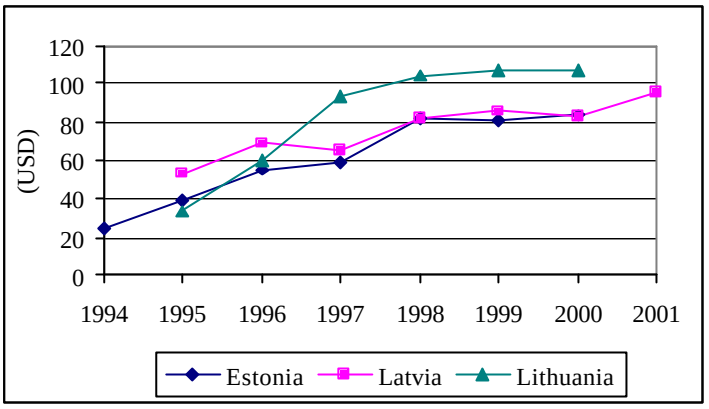


**Figure 8 Minimum wages in Baltic States 1994 – 2001**[19]

In the Figure 8 it can be seen that over the time period 1994 – 2000 the highest minimum wage has been in Lithuania, the lowest in Estonia although in last years it has been almost at the level of Latvian minimum wage. In Latvia the minimum wage is since 1st July 2001 EUR 104 and in Lithuania form 1st January 2001 125 EUR) (in Estonia – 90 EUR). Still it is argued that in Lithuania the enforcement of minimum wage is almost nonexistent. Speaking about the level of minimum wage in European Union countries as a comparison, the lowest minimum wage in 1999 was in Portugal (359 USD) and the highest was in Luxembourg (1168 USD). The first one is about three times and the second one is about ten times as high as in Baltic States.

At the same time the highest average wages have been in Estonia (Figure 9). The Latvian and Lithuanian wages seem to be quite similar. As in the last years the growth of Estonian average wages has slowed down, Latvian and Lithuanian average wages have had the possibility to converge with Estonian wage level. But the difference between average wages in Baltic States and in European Union is still very large – in 1999 the lowest average wage was in Portugal (653 USD) that is more than two times as high as in Estonia and the highest was in Luxembourg (2866 USD). This is about ten times as high as in Estonia. Such huge differences between wages (especially between minimum wages) in Baltic States and in European Union may indicate also that the wages in Baltic States are more flexible than in European Union.

[19] Minimum monthly earnings, LTL, http://www.std.lt/STATISTIKA/Socialine/Darbo_uzm_e.htm, 30.05.2002
Minimum wages in Latvia, http:// www.mac.doc.gov/eebic/cables/1997/dec/rig179.htm 06.06.2002
Minimum wages in Latvia, http://www.balticdata.info/latvia/macro_economics/latvia_macro_economics_employment_basic_information.htm 06.06.2002

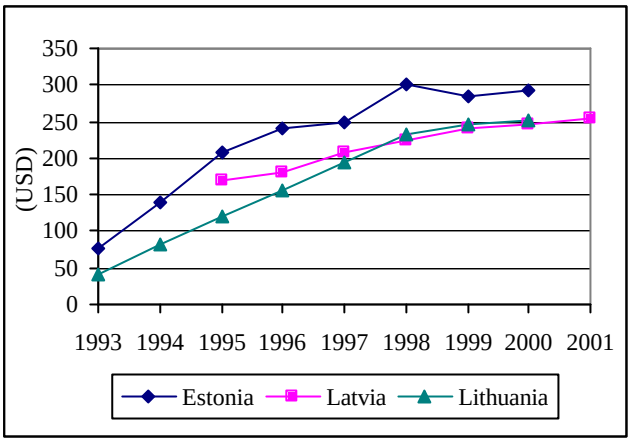


**Figure 9 Average wages in Baltic States 1993 – 2001.**

The easiest way to say whether the wages in Baltic States are flexible or not is to find out if there is a fall taken place in wages of those sectors that were tightly connected to Russian market.

### Estonia

Figure 10 presents the wage indices of these economic sectors where the fall in nominal wages took place in 1999 are shown in comparison with the total wage index. It can be seen that three of the four sectors are sectors where growth of wages is lower than the growth of wages in the whole economy. The agriculture is the sector where the growth rate of wage is higher than the total growth but the wages in agriculture make a bit more than a half of the total average wage (see Figure 7). The same is about hotels and restaurants but here the wages grow slower than the total average. In the hotels sector the jump downward in 1999 was the steepest. The wage dynamics in other sectors can be seen in Appendix 1.

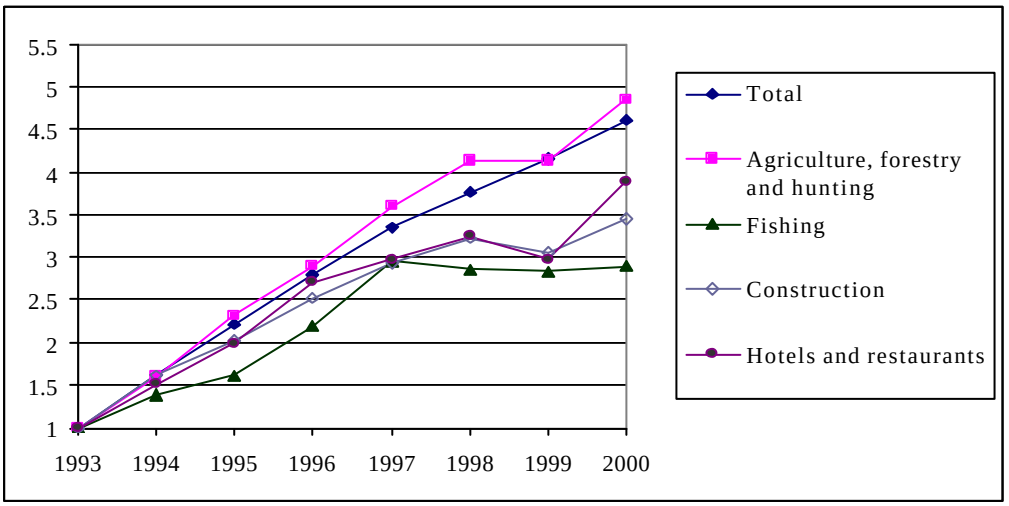


**Figure 10 Estonian gross nominal wages by economic activities.**

**Latvia**

In Latvia the falls in wages were mostly smaller than in Estonia. When looking at fishing, we can see that the wage declined there already in 1998 both in Latvia and Estonia. In the case of Latvia the fall was especially remarkable (Figure 11). At the same time the wages in construction fell only in 2000. This may indicate that the Latvian wages in construction are a bit more rigid than in Estonia.

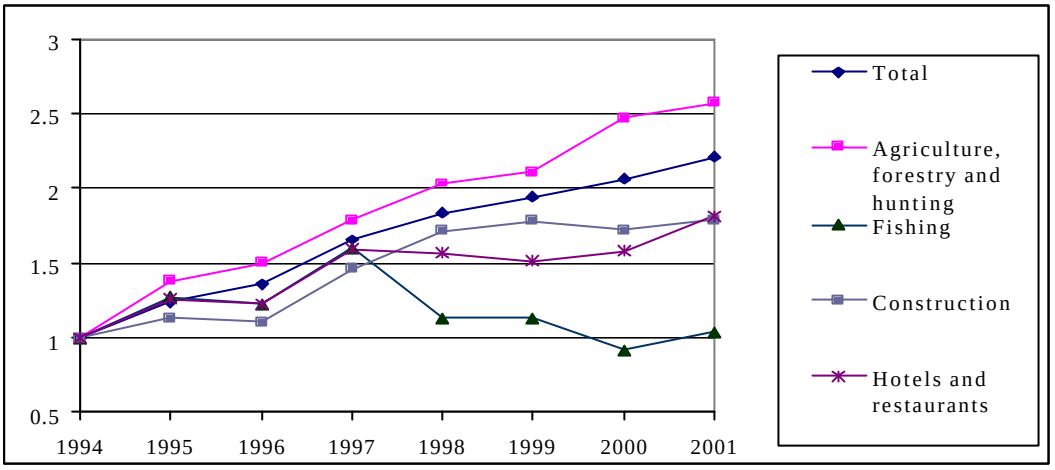


**Figure 11 Latvian gross nominal wages by economic activities.**

**Lithuania**

Compared to Estonia and Latvia, Lithuanian wages are considerably higher in financial intermediation, public administration and compulsory social security (Figure 7 ). A bit higher wages may also be detected in manufacturing and construction, while wages in agriculture, forestry, hunting and fishing, remain bit lower than in other Baltic States. Considering quite large size and importance of agricultural sector in Lithuania (employed persons in agricultural sector in 2000 was 21%, while same number in Latvia was 15% and in Estonia 7%) latter must be taken account.

From the graphs of wage dynamics of Lithuanian economy by sectors we see sharp nominal gross wage rise in year 1994, following decline in 1995. During the remaining of the sample period, from 1995 till 1999, we see reasonable wage growth, which do decline after 1998, but in hardly noticeable amount and do not get negative. This is quite surprising as the influence of Russian crisis to Lithuanian economy was the biggest among three countries, economic growth in constant prices was –3.9% and inflation slowing down to 0.3%. The influence of crisis to nominal gross wages seems to be the smallest in agricultural and fishing sector (see Appendix 3).

Shocks influence seems to be the highest in industrial sector, where nominal wages in construction even decrease (see Figure 12). At the same time it is also remarkable that wages in public sector fell a bit, too.

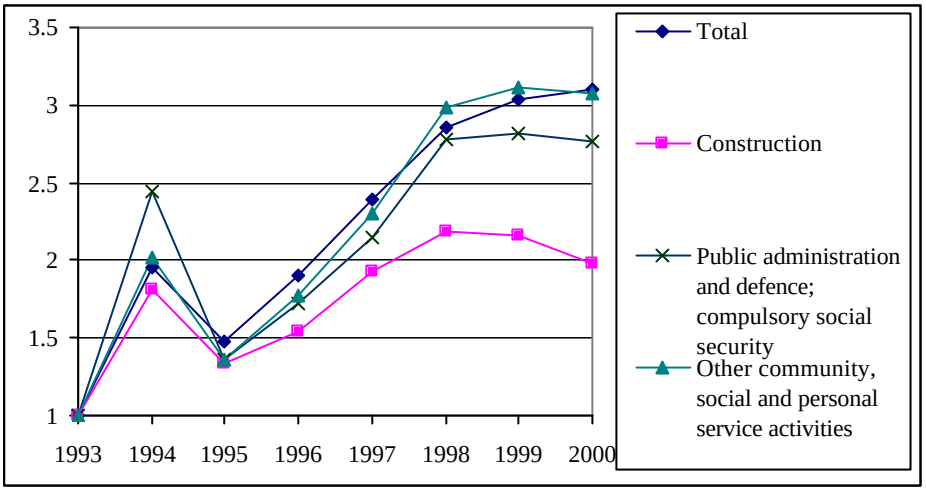


**Figure 12 Lithuanian gross nominal wages by economic activities**

Lithuanian nominal wage dynamics is different compared to the other Baltic States. While in other countries the Russian shock has bigger influence in agricultural sector and smaller influence in sectors of non-tradables like services and public goods, the opposite dynamics can be seen from Lithuanian figures. The only sector which suffered similarly in all three countries after Russian crisis is industry and even here we have to add smoother exception — Latvia does not suffer that much. It can be guessed that the crucial point here is the share of the particular sector's export to Russia, but we can not dismiss the fact that in some countries and some industries wages react in a more sensitive way than in others. In this respect Lithuania seems to have more rigid wages than Estonia and Latvia and the rigidity seems to be the highest especially in agricultural sector. This may be a reason why Lithuania suffered longer after Russian crisis than other Baltic States.

In summary, the nominal wages are most rigid in Lithuania and most flexible in Estonia. The most flexible wages are in the construction sector in all three countries. In Estonia and Latvia also the wages in fisheries, hotels and restaurants and a bit less in agriculture are flexible, too. The wages in the public and in the financial sector are mostly rigid. The data shows that if the wages are lower they are more flexible, too. In the context of EU enlargement one possibility is that wages in these sectors where they are most flexible will converge faster with the EU wage level if EU labour market policies will be liberalized. The other possibility is that if the

labour markets will be regulated as highly as in EU, the wage flexibility will decrease in all three countries, especially in Estonia. The last possibility is more realistic one.

# 6. International labour migration

Increasing labour migration between East and West, which is determined by various socio-economic and political reasons, is undoubtedly one of the possible consequences of the EU eastward enlargement processes that should be focused on when analyzing possible changes in the labour markets of both, the current EU members as well as the accession countries. Lessons of labour migration in Europe in 1960-1970s and particularly during the EU previous enlargement processes are the most valuable sources in order to make some predictions about international labour migration as a result of EU and Eurozone eastward enlargement.

Theoretically labour migration is a result of rational choice oriented at certain system of values. One of the conditions of migration movements is an existence of more or less stabile social context composed of people which needs are satisfied at least in minimum. If those minimal needs within one social context are not fulfilled some people emigrate to a new social context, where they will find better conditions to fulfil their needs or expect relatively smaller deprivation and better possibilities for development (see also Mangalam and Morgan, 1968). That is one possible explanation of the labour migration phenomenon, which certainly does not completely explain all factors and consequences of the labour movement during the EU eastward enlargement. Actually, there is no single, coherent theory of migration, only a fragmented set of theories that have often developed in isolation from one another[20].

According to neoclassical economic theory, international labour flows exist as a consequence of real wage differences between counrties. The international labour flows should create a new international equilibrium in which real wages have the same level in all countries (Borjas, 1989; Öberg, 1997). In Keynesian theory labour supply depends on nominal wage, not only on real wage. This distinction originates in the different views on the role of money. Money is not only a medium of exchange but also a medium of saving and therefore potential migrants are also attracted to high nominal wage regions. Intensions to re-emigrate or to send remittances increase the importance of the nominal wage level compared to the real wage level This aspect of Keynesian theory also allow us to state that unemployment difference

[20] The set of theories trying to explain migration processes includes neoclassical theory of migration, segmented labour market theory, world system theories, , human capital theory, new economics of labour migration, dual labour market theory, the gravity model based approach etc.

between a sending and a receiving country has positive effect on amount of labour migration between countries (see also Jennissen, 2002)..

Piore (1979) gives three possible explanations for the demand of foreign workers in modern industrial societies: 1) general labour shortages, 2) the need to fill the bottom positions in the job hierarchy, and 3) labour shortages in the secondary segment, which is characterized by a labour-intensive method of production and predominantly low skilled labour market. Hence, the dual labour market theory also explores reasons and consequences of international labour migration and stresses the necessity to analyze the low and high skilled labour flows separately (see case studies "Migration from Portugal to Switzerland: Low skilled, 'classical' labour migration" and "migration from Sweden to Norway: High skilled 'post-industrial' labour migration"; Jennissen, 2002), that will certainly provide some lessons for exploring and predicting possible changes in the EU labour market after eastward enlargement..

International labour migration in Europe in the 1960s and early 1970s mainly consisted of low skilled labour migration. The domestic labour force in many Western European countries could not comply with the high demand for manual labour. Many labour migrants went from Southern Europe (Greece, Italy, Portugal, Spain) and Turkey to Western Europe. Also many workers moved from Ireland and Finland to UK and Sweden. After the economic recession in the first half of 1970s these labour flows mainly ended, and many labour migrants returned to their country of origin. Labour migrants who did not return decide to let their family come over. Family and return migration were the main characteristics of the international labour migration in the second half of the 1970s and in the beginning of 1980s. In the second half of 1970s also post-colonial migration was rather important, particularly in the case of Portugal and the Netherlands. The post-industrial type of international migration, which consists of combination of high and low skilled labour migration (including also clandestine and asylum migration), is emerged since 1980s.

In general the reasons for migration could be divided into pull and push factors that promote or restrain migration. The factors are nominated as pull or push factors depending on whether these factors emanate from the source (home) or destination (host) country. The main pull factors include good employment opportunities and high potential income in the country of destination. The main push factors are ordinarily high unemployment and low earnings in the home country. But it is obvious that reasons of international labour mobility are not only determined by economic factors. Additionally to economic factor there are also

legislative (legislation that regulate labour movement between the countries, labour legislation), demographic (number and structure of population), political, social, psychological, cultural, historical factors. Of special importance is the influence of migrant networks, which may help potential migrants of the same ethnic origin to find a job and to get information about accommodation and proper labour and social policy measures, etc. Also differences in educational level of sending and receiving countries influencing labour migration. For instance, the high educational level of a sending country may have a negative effect on low skilled labour flows from this country.

In the second half of 1990s numerous studies have been made on the prospects of international labour migration after EU eastward enlargement, when the current regime will be replaced with the right of free movement of labour. The forecasts of possible labour movements between the countries in absence of administrative restriction vary considerably depending on methodology and assumptions used within the studies (Brücker and Boeri, 2000; Sinn, et al, 2001, Walterkirchen and Dietz, 1998, Bauer and Zimmermann, 1999, Hille and Straubhaar, 2000). The main methodological distinction is between surveys and quantitative models. Surveys recording intentions and desires do not pretend to predict actual movement. Model-based studies remain relatively uncertain due to the complexity of factors influencing migration and reliance on strong assumptions. They attempt to transpose patterns observed in major recent migrations, and crucially depend on the assumptions that they will be reproduced in the case of enlargement. Uncertainty is also enhanced by reliance on very long-term forecasts of economic development in the EU and candidate countries (see also EC, The Free Movement of Workers… 2001). The fact that uncertainty remains high regarding to the future migration is also underlined in the Eurostat studies[21]. Two important assumptions are made in these studies1) the present distribution of candidate country nationals among member states will not change and 2) that the share of employees is based on the present (rather low) share of employees among residents. These assumptions could distort the picture somewhat insofar as the present distribution and employment rate are the result of quite different historical circumstances and migration patterns than those that will prevail after accession in a context of free movement.

[21] EUROSTAT (2000a): Patterns and Trends in International Migration in Western Europe. Eurostat Studies and Research, Luxembourg, 2000
EUROSTAT (2000b): Europäische Sozialstatistik – Wanderung, Ausgabe 2000, Brüssel.

Estimates that base on various research studies put the long-run migration potential from the candidate countries roughly 1% of the EU15 population (hence, about 3.8 millions). Surveys suggest a strong preference of candidate country nationals for temporary work, which implies also important flows of return migration towards the candidate countries. Based on some predictions in absence of administrative restriction for labour movement, the initial immigration from the CC8 countries (the European candidate countries excluding Bulgaria and Romania) into EU15 would be around 70 000 workers annually (that means totally 200 000 people including also family members) or 0.05% of the EU15 population (The free…, 2001, pp.7-8).

According to the study of Brücker and Boeri (2000), labour migration would be concentrated in only a few member states and enlargement will not significantly affect wages and employment in the EU. It is expected that two-thirds of the labour migration flows from the candidate countries will be absorbed by Germany (hence, around 45 000 – 50 000 workers per year from the CC8 in the first few years). Austria will absorb about 20% of the labour flows coming from the CC8. The forecasts show that the share of the CC10 people in the population of the present EU member states would rise from 0.2% in 1998 to 1.1% in 2030 (Ibid., p.9).In sum, according to predictions, the movement of labour between the EU countries after eastward enlargement will not be significant.

Analyzing stock of labour force in EU current members emigrated from non-EU countries we could say that this amount is not significant. In 1999 the stock of labour force in EU15 from non-EU countries was about 5.3 millions (or 3.1% of EU total labour force, and the number of residents was about 12 millions (3,2% of total EU residents). At the same time number of official labour force from the candidate countries (CC) was only 290 000. Additionally to this people who are officially working in the EU member states, some estimates show that there is also about 600 000 “working tourists” from the candidate countries (Eurostat, 2000a and b). Hence, we could conclude, that the stock of emigrants from the candidate countries is not large and there is also no well developed and institutionalized migrant networks that could support East-West labour migration.

The number of residents in the EU member states from the Baltic States is also insignificant. In 1998 these numbers were respectively about15 000 from Estonia, 7500 from Latvia and 8500 from Lithuania (table below). Total number of the Baltic States population is about 7.6 millions (1.45 millions in Estonia, 2.44 millions in Latvia and 3.70 millions in Lithuania) and

the share of the Baltic nationals in the EU member states form only about 1% of Estonian, 0.3% of Latvian and 0.2% of Lithuanian population. It is obvious that changes in the Baltic States' labour markets and labour flows from these countries will not have any significant impact on the EU labour market as a whole.

**Table 7. Stock of Baltic Citizens in the EU Member States in 1998**

| | Germany | Finland | Sweden | Denmark | Holland* | Italy | Greece | Spain | Portugal |
|---|---|---|---|---|---|---|---|---|---|
| Estonia | 3173 | 9689 | 1124 | 384 | 100 | 98 | 36 | 31 | 2 |
| Latvia | 6147 | 134 | 387 | 449 | 110 | 168 | 73 | 36 | 1 |
| Lithuania | 6631 | 163 | 358 | 555 | 260 | 174 | 109 | 65 | 10 |
| Total | 15951 | 9986 | 1869 | 1388 | 470 | 440 | 218 | 86 | 13 |
| Baltic nationals in the EU in % of total population in the Baltic States | | | | | | | | | |
| | 1.01 | 0.31 | 0.22 | | | | | | |
| Baltic nationals in the EU in % of total population in the certain EU Member States | | | | | | | | | |
| | 0.02 | 0.19 | 0.02 | 0.03 | 0.002 | 0.001 | 0.002 | | |

Source: Eurostat, 2000 a and b; Authors calculations

* The study assumes accession in 2002 of all candidate countries. Its oft-quoted estimate of 335,000 refers to the total number of people migrating from all candidate countries in 2002, of which 35% would be employees.

Analyzing labour migration problems of the Baltic States, the emphasis should be first of all given to possible labour movement within the Baltic Sea region[22]. The integration of border regions appears to be relevant in the EU forthcoming enlargement. The countries, which mainly attract the Baltic States' labour force, are the current EU member states that belong to the Baltic Sea region: Denmark, Finland, Sweden and Germany.[23]

According to the Eurostat data (2000), more than 90% of Baltic nationals in the EU15 are living in the Baltic Sea region countries (98.2% of Estonians, 91.8% of Latvians and 92.6 of

[22] The integration of the Baltic Sea region countries into the EU has more than twenty-five years of history starting from January 1, 1973 when Denmark became a member of the EU. The collapse of the Berlin Wall and the German unification moved the EU border to the east and Germany became the biggest Baltic Sea region country. After several years of negotiations and preparations, Sweden and Finland joined the EU in January 1, 1995. This marked the next stage of the EU enlargement (the northern enlargement). As the Baltic Sea region countries with developed market economies strove for the EU membership, transitional countries of the region (Poland, Estonia, Latvia, Lithuania) created a network for integration first of all in the field of international trade: free trade areas with EFTA countries, the Baltic Free Trade Area (covering Estonia, Latvia and Lithuania), CEFTA, etc. These four Baltic Sea region countries are also candidates for the EU eastward enlargement. In 1995 the Baltic Sea was declared as an inland sea of the EU. This event was of strategic importance for the integration of the countries around the Baltic Sea – Scandinavian countries integrating with Central and Southern Europe and the Mediterranean; countries in transition associated with the EU pursuing the process of adjustment on macro, meso and micro scale at the same time. The strong feeling of the Baltic identity and responsibility for the sea have brought people together already for centuries.

[23] According to the survey information of the Ministry for Social Affairs and Labour of Lithuania (2001), Lithuanians have mainly worked in the following countries in the recent years: Russia – 20.3%, Germany – 18.6%, Great Britain – 9.9%, US – 8.1%, Denmark – 7.6%, Italy – 6.4%, Sweden – 4.1%. Hence, more than 50% of Lithuanians that temporarily worked outside of the home country made that in the Baltic Sea region countries.

Lithuanians). At the same time, due to very small population size of the Baltic States, the share of the Baltic nationals in the population of these countries is insignificant; it does not exceed 0.2%. The main stock of Estonian citizens is living in Finland (66% of Estonian citizens living in the EU member states), of Latvian and Lithuanian citizens in Germany (respectively 82% and 80%). There are probably some migrant networks that may support migration of the Baltic States labour force to the Baltic Sea region countries only in Finland and also Germany. But these possible networks are not institutionalized and do not play a significant role in attracting labour force from the Baltic States.

The main economic pull and push factors that influence labour movement within the Baltic Sea region countries are presented in table below. Distance between the Baltic Sea region countries is expressing not only economic costs of migration but also cultural proximity and historical relationships between the countries. Detail description of the factors influencing labour migration giving emphasizes to factors that influence labour movement of the Baltic States is in the Appendix 11.

**Table 8. Factors influencing the Baltic Sea region countries' labour migration, 2000**

| Factor | The Baltic States | The Baltic region countries – the current members of EU |
|---|---|---|
| **GDP (PPP) per capita, int.$** | Estonia – 10068; Latvia – 6893; Lithuania – 7094 | Denmark. – 27404; Finland – 25154; Germany – 25290; Sweden – 24288 |
| **GDP (MER) per capita, USD** | Estonia – 3577; Latvia – 2938; Lithuania – 3044 | Denmark – 30400; Finland – 23418; Germany – 22829; Sweden – 25627 |
| **Number of population (Mil.)** | Estonia – 1.45; Latvia – 2.4; Lithuania – 3.7 | Denmark – 5.3; Finland – 5.2; Germany – 82; Sweden – 8.9 |
| **Unemployment rate (%)** | Estonia – 13.9%; Latvia – 14.7%; Lithuania 15.9% | Denmark – 4,6 %; Finland – 9,7 %; Germany – 10% ; Sweden – 4,7 |
| **Distance (km, between the capitals)** | Est-Den.: 482; Est-Ger.: 1045; Est-Swe.: 383; Est.-Fin.: 84 | Den.-Est.: 842; Den.-Lat.: 733; Den.-Lit.: 826 |
| | Lat.-Den.:733; Lat.-Fin.:361; Lat.-Ger. 850; Lat.-Swe.: 450 | Fin.-Est.: 84; Fin.-Lat..361; Fin.-Lit: 611 |
| | Lit.-Den.:826; Lit.-Fin.:611; Lit.-Ger.:828; Lit.-Swe.: 686 | Ger.-Est: 1045; Ger.-Lat.: 850; Ger.-Lit.:828 |
| | | Swe.-Est.:383; Swe-Lat: 450; Swe-Lit: 686 |

*Sources:* Financial Statistic Yearbook, IMF, 2001; World Bank, 2001 (www.worldbank.org); Statistical Office of Estonia, 2001; The Baltic and the Nordic Countries. Central Statistical Bureau of Latvia, 2000. International Labour Organization 2002 (www.ilo.org), Estonia, Latvia, Lithuania in Figures 2000, Statistical Office of Estonia, Tallinn, 2000.

According to the survey information of the Ministry for Social Affairs and Labour of Lithuania (2001), Lithuanians have mainly worked in the following countries in the recent years: Russia – 20.3%, Germany – 18.6%, Great Britain – 9.9%, US – 8.1%, Denmark – 7.6%, Italy – 6.4%, Sweden – 4.1%. Hence, more than

50% of Lithuanians that temporarily worked outside of the home country made that in the Baltic Sea region countries.

The consequences of EU enlargement for international labour migration depend also on legal conditions for international labour movement. If citizens of the candidate countries are allowed to work in all EU countries immediately after joining the EU, then significant East-West labour flows probably will exist during the first years of EU eastward enlargement. Especially Germany and Austria fear remarkable labour migration. Therefore, it is likely that similar to with the enlargement of the EU with Greece, Portugal and Spain, a transitional agreement with respect to free labour movement will probably be formulated.

**Table 9 The conditions of the labour market access in the Baltic Sea region countries, the current members of EU in 2000**

| Country | Access of third country nationals to the labour market | Special regime for candidate countries | The long-term residence permits |
|---|---|---|---|
| **Denmark** | Very limited access. Work permit needs to be obtained prior to entering the country. Labour market need has to exist. Total number of permits in 1999: 73 092. | No special regime | In general, if a work permits granted a residence permit will also be granted. |
| **Finland** | Work permit needs to be obtained prior to entering Finland. Labour market has to exist. Privileged regimes foe qualified workforce. | No special regime | Usually for 1 year, after 2 years a permanent residence permit may be granted |
| **Germany** | Residence permits (granted up to 5 years) and work authorization needed. Work permit normally requires existence of need in labour market. Total number of permits in 1999: 1 083 268 | Quota-based agreements on trainee workers with Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. | – |
| **Sweden** | Different countries decide together with the national authorities on the issuance of temporary work permits. Work permits are only issued in case of labour shortage. Total number of foreign workers about 220 000. | Bilateral agreements on trainees. | After 2 years of residence a permanent residence permit may be applied for. |

Source, The free movement…., EC, 2001

The conditions of present labour market access in the Baltic Sea region countries – the members of the EU15 are presented in the Table 9. Due to very small size of the Baltic States labour markets, the Baltic influence on the EU labour market will not be significant even if people from the Baltic States will immediately after joining the EU get free access to the labour markets of all EU member countries. Probably, the most significant will this

influence be to Finland as to the Baltic Sea region industrialized country with small open economy.

Average educational level in the Baltic States like in other Central and Eastern European countries is high and therefore it is playing comparatively insignificant role in determining labour migration. If there will be the recognition of diplomas of the accession countries people, it is also predictable that there will be some increase of high skilled labour force movement between East and West (both sides) and the wages of highly qualified persons will rather quickly create a new wage equilibrium. Educational level in some accession counties including the Baltic States is even approaching the natural upper limit. Thus, with respect to educational level former low skilled labour migration from less developed regions in the EU cannot be compared with future low skilled migration from accession countries. It is also predictable that due to significant differences in real and nominal wages and structural unemployment in most of accession countries (also in the Baltic States) comparatively well educated people will move to the industrialized EU countries in order to work there as blue colour workers.

It is highly probable that cross-border movement in border regions of the Baltic States will significantly increase after free movement of labour will be achieved. Cross-border movement includes commuting by employed persons, or occasional jobs of few days or weeks, sometimes also few moths. Cross-border workers keep their house and family in their home countries and thus avoid the high transaction cost of moving to another country. The cross-border workers ordinarily take their wage back to the home country, and hence, the wage gap should be assessed taking into account the higher purchasing power of their wage at home. It is predictable, that cross-border work can be first of all costly to the country of residence, which may not receive income tax revenue from the worker but has to finance social expenditure and local infrastructure for the benefit of the worker's family. The employing country even enjoys corresponding financial advantages.

In summary, due to the very small size of the Baltic labour markets comparing to the rest of EU, labour migration from the Baltic States into the EU15 countries will not be significant in the near future. Based on experience of the previous stages of the EU enlargement and the predictions that labour migration will not exceed 0.2% % of population, it is possible to estimate that in the first years of free movement of labour, migration from Estonia could be about 2500-2800 people per year or about 10000 - 14000 during the first four-five years; 5000-6000 people per year from Latvia (about 15000-23000 during the four-five years

period); and 7000-8000 per year from Lithuania (about 27000-37000 during four-five years). Over long-term period (10 years period) the labour migration is declining.

Previous experience and research studies also show that labour migration processes have had little effect on host country unemployment and wages (Sinn, 2001). Migration of labour from a home country to a country of destination can even provide gain for the host country, since migrants generally receive a wage below the gain in value added to the economy. Income earned by immigrants does not usually create a burden for the domestic population. There are also possibilities of additional investment income, rents and increased consumer spending. As regards public finances, immigration impacts on government expenditure and revenues, but the net impact at the national level is negligible. In a long-term perspective, immigration can limit the adverse impact on living standards and government budgetary positions due to declining and ageing of populations. Of course, labour migration cannot on its own solve the ageing problem of the European population. In order to maintain a sufficient labour force, additionally to import of labour through migration, the European countries have significantly reduce unemployment rate and to increase the participation rate in their labour markets.

Free movement of labour will have rather serious pressure on the labour markets of the Baltic States due to possible movement of better-qualified and flexible labour force. Movers will be mainly people with good qualification, also young people with secondary school (gymnasium) education, who do not find qualified job at home. They are ready to work abroad as blue colour workers getting salaries which are relatively higher that their expected to get in their home countries. Also possible cross-border movement of workers in the Baltic Sea region will have a pressure on the Baltic States' labour markets.

In conclusion, analysis of labour migration experience of the previous stages of EU enlargement allows us to summarize;

1) Free movement of labour will not have a significant pressure on the labour markets (first of all on the level of unemployment and wages) of the EU current member states. The main absorbers of the labour flows from CC10 will be Germany and Austria.
2) Due to the very small size of the Baltic labour markets comparing to the rest of EU, labour migration from the Baltic States into the EU15 countries will be insignificant and will not have any remarkable pressure on the EU labour market.

3) Due to historical and cultural conditions and close neighbourhood, the migration of the Baltic States labour force will be mainly to the Baltic Sea region countries. The growth of the cross-border movement is expected. Cross-border movement of labour could be comparatively costly to the country of residence.
4) Free movement of labour will have a certain burden on the home countries' economy. It is predictable that movers belong mainly to qualified and flexible labour force.
5) The European countries have significantly reduce the unemployment rate and to increase the participation rate in their labour markets in order to maintain a sufficient labour force for sustainable development. Import of labour is not the only source for solving demographic problems. Hence, growth of labour flexibility is unavoidable is order to achieve a sustainable development in all European countries in context of EU eastward enlargement.

# 7. Conclusions

The aim of the paper was to give an overview of the main changes in the Baltic States' labour market over the period (1990 – 2001) giving emphasis on the problems of labour flexibility and migration in the EU eastward enlargement context. Two sides of the macro level labour flexibility were discussed: institutional flexibility (labour legislation, labour policy, trade unions) and wage flexibility.

The Baltic States have followed main international standards that regulate labour relations: the most important ILO conventions are ratified and the legislation assures the protection of employees' rights in terms of work time, work remuneration, holidays, and termination of contracts. There are several measures to protect employees in less favourable conditions like old-aged employees, women with children, dsabled persons etc. Of course there are also some differences in regulation measures between the Baltic States. For instance, in Lithuania the legal regulation has more adverse impact on labour market flexibility than in Latvia: higher minimum wage, longer advance notice period and bigger compensations when employer terminates employment contract. Also summary the index measuring legal restrictions for individual dismissals showed that the dismissals are less regulated in Latvia than in Estonia and Lithuania; the value of index for the Baltic States is higher than the average of the European Union. On the other hand the usage of fixed term contracts is less restricted in the Baltic States than in the EU and in Lithuania their usage is less restricted than in Latvia and Estonia. As separate laws regulate the status of civil servants, they have some

advantages, but are also subject to additional duties. The status of the unemployed people is regulated and they are subject to several rights. In Lithuania the unemployed people enjoy higher unemployment benefits and the conditions for getting these are less stringent than in Latvia.

Trade unions in the Baltic States like also in all Central and East European countries are rather small in both the union density and collective agreements coverage. The importance of trade unions has been decreasing in CEE and Baltic countries since beginning of 90s. In the end of 90s trade union density was less than 35% in all the transition countries except Slovenia. In the Baltic States trade union density is even smaller compared with the CEE countries' average with the largest density rate in Latvia. Collective agreements' coverage in the Baltic States is not much higher than the union density. This is mainly due to the small number of sectoral level agreements. Collective wage bargaining in the Baltic States takes place mainly at the enterprise level or national level. At sectoral or regional level the bargaining process is less developed. Due to the low coverage of collective agreements, it can be concluded that more employees in the Baltic States rely on individual employment contracts.

Analyzing wage flexibility in the Baltic States, it is possible to summarize that wages are rather flexible, but there are also differences between countries and economic sectors. The nominal wages are most rigid in Lithuania and most flexible in Estonia. At the same time the minimum wages are the lowest in Estonia and the highest in Lithuania. The most flexible wages are in construction sector in all three countries. In Estonia and Latvia the wages are also flexible in fishing, agriculture, hotels and restaurants sectors. The wages in public sector and in financial sector are mostly rigid. The data also show that if the wages are low they are more flexible. In the context of EU enlargement it is possible that the wages in these sectors where they are most flexible will converge faster with the EU wage level if EU labour market policies will be liberalized. It may also happen that if the labour markets of the Baltic States will be regulated as highly as in EU, the wage flexibility will decrease in all three countries, especially in Estonia. The last option is more realistic one.

Labour policies are rather insufficiently funded in the Baltic States compared to the EU and the share of active measures is relatively low. In Lithuania 40% and in Estonia even 60% of the overall employment policy budget is allocated on passive measures. At the same time, the overall coverage of the unemployed by the system of income maintenance is still low in all

three states. The participation of registered job-seekers in active labour market measures is low too. In accordance with the European Union employment guidelines the goal is to achieve the involvement rate of 20% unemployed. At the moment, the respective number is highest in Estonia - 10%, followed by 4% in Latvia and 3% in Lithuania. It could be concluded that because of the undercapitalization of the labour market policy, the unemployment benefits are low and in this way do not decrease remarkably the labour flexibility. On the other hand, through placing stronger emphasis on active labour market programmes, the positive impact of labour policy on labour flexibility could be increased. In this context, more attention should be paid on education and training, including development of lifelong learning which is now an established priority throughout the EU.

In conclusion we can say that labour market flexibility is relatively high in all three Baltic States. It is a bit higher in Estonia (wage flexibility), and lower in Lithuania, but in all three states the flexibility has declined in the course of transition.

According to numerous studies that emphasize the prospects of labour migration after EU eastward enlargement, when the current regime will be replaced with the right of free movement of labour, the long-run migration potential from the candidate countries to the current EU members will not be significant, roughly 1% of the EU15 population (hence, about 3.8 millions). Analyzing labour migration problems of the Baltic States, the emphasis should be first of all given to possible labour movement within the Baltic Sea region. The integration of border regions appears to be relevant in the EU forthcoming enlargement. The countries, which mainly attract the Baltic States' labour force, are the current EU member states that belong to the Baltic Sea region. It is highly probable that cross-border movement in border regions of the Baltic States will significantly increase after free movement of labour will be achieved. Cross-border movement is first of all costly to the country of residence, which may not receive income tax revenue from the worker but has to finance social expenditure and local infrastructure for the benefit of the worker's family. The employing country even enjoys corresponding financial advantages.

To sum up, labour migration from the Baltic States into the EU15 countries will not be significant in the near future. Based on experience of the previous stages of the EU enlargement and the predictions that labour migration will not exceed 0.2% of population, it is possible to estimate that during the first four-five years these are estimated to be for the Baltic States between 52 and 74 thousand. Over long-term period (10 years period) the labour

migration is declining. Free movement of labour will have rather serious pressure on the labour markets of the Baltic States due to possible movement of better-qualified and flexible labour force. Movers will be mainly the people with good qualification, also young people with secondary school (gymnasium) education, who do not find qualified job at home. They are ready to work abroad as blue colour workers getting salaries, which are relatively higher than their expected to get in their home countries. Also possible cross-border movement of workers in the Baltic Sea region will have a pressure on the Baltic States' labour markets.

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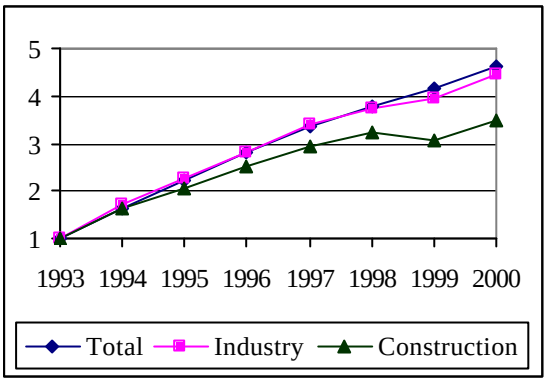
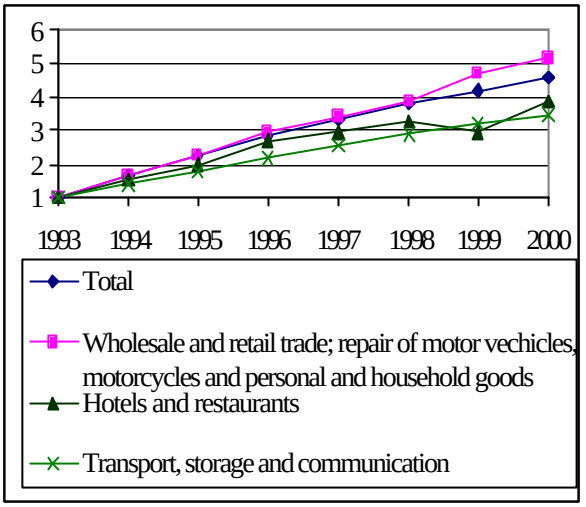
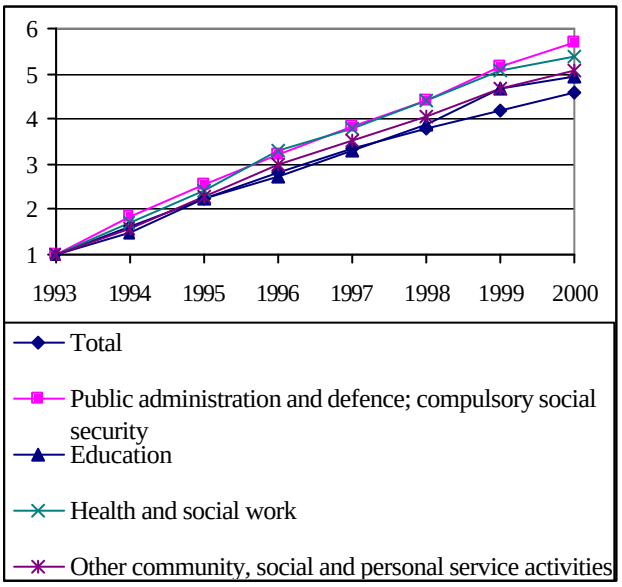
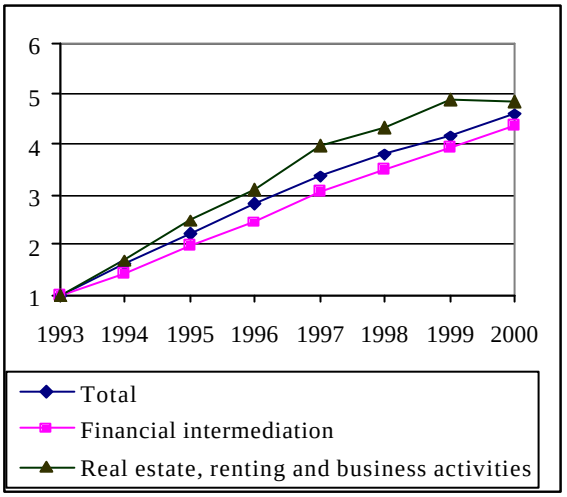
# Appendix 1 Gross nominal wages by economic activities - Estonia

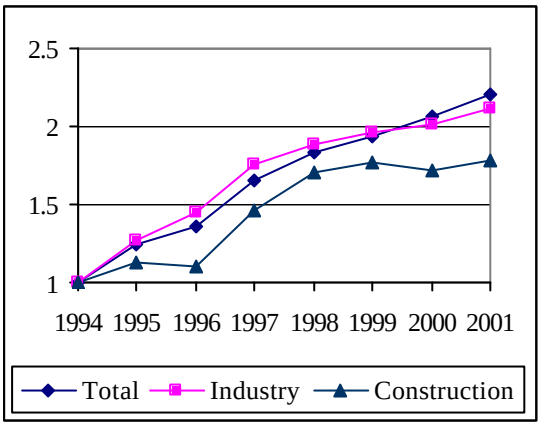


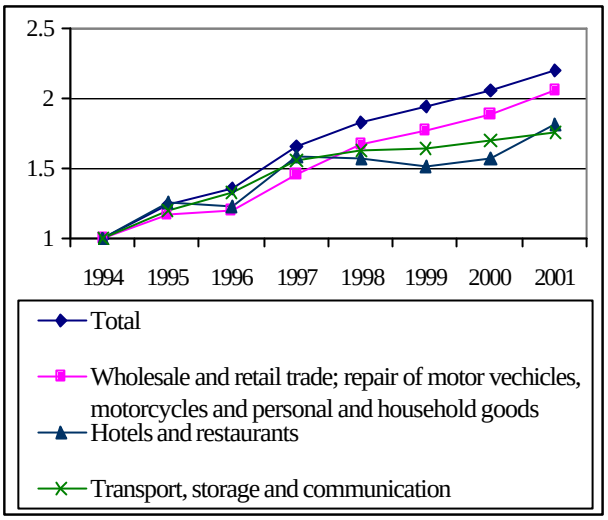



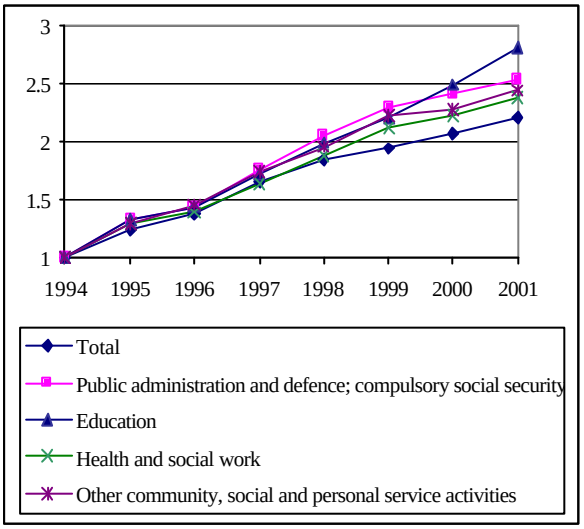



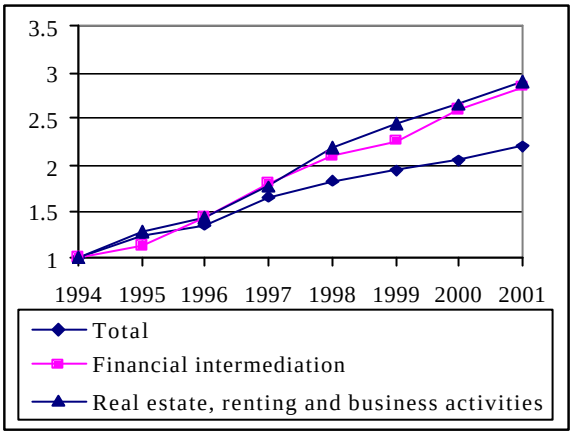



# Appendix 2 Gross nominal wage indices by economic sectors - Latvia

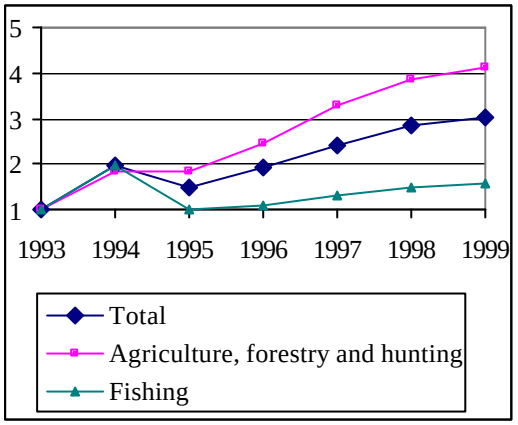


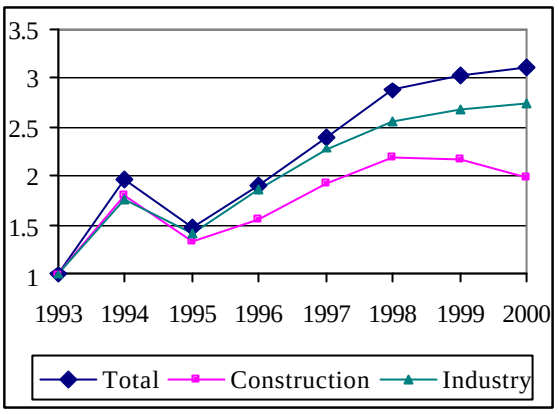



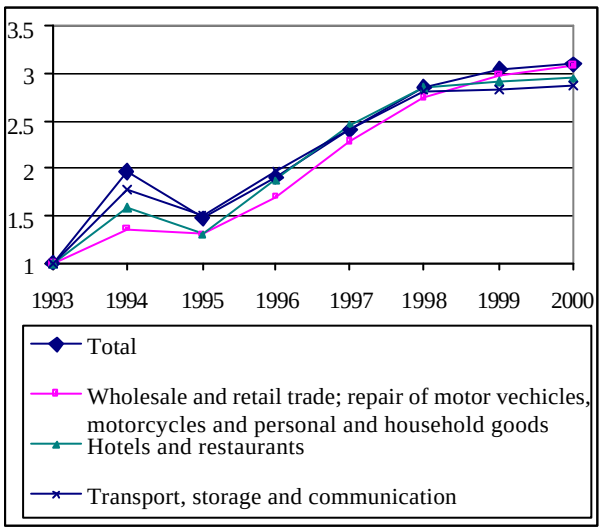



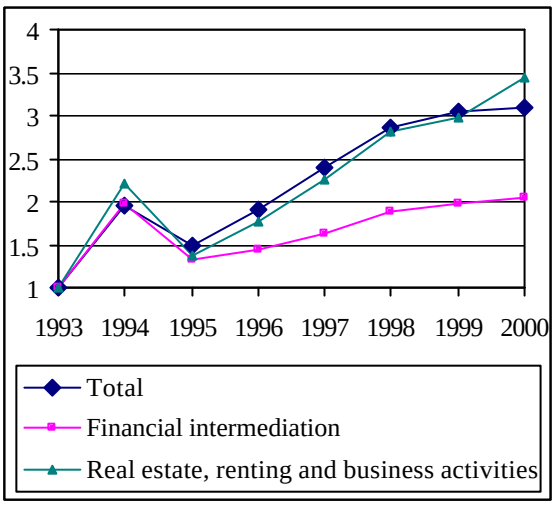



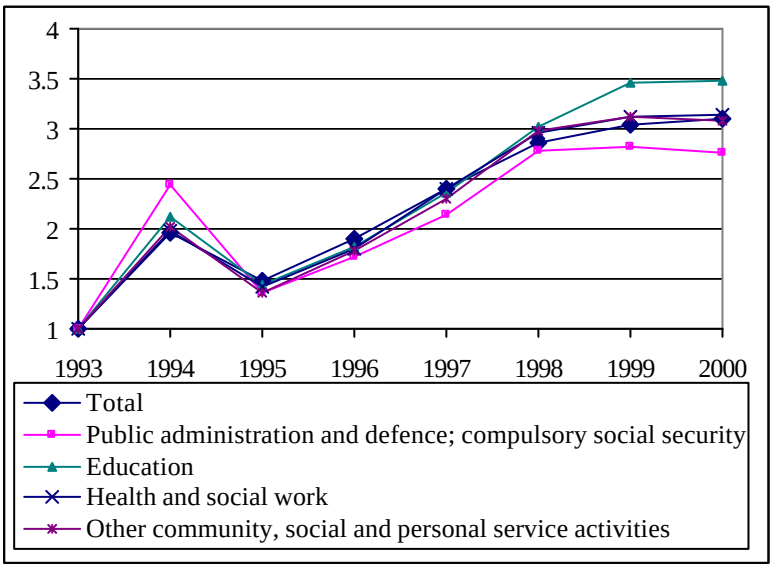
# Appendix 3 Gross nominal wage indices by economic activities - Lithuania



## Appendix 4. The mandatory provisions of the employment contract in Latvia, Lithuania and Estonia[24]

The mandatory provisions of the contract are as follows:

1. the employee's place of work (enterprise, its subsidiary, etc.);
2. the functions of employment - in regard to a certain profession, speciality, qualification, or post; and
3. the salary.
4. The term of an employment contract (if the term is not specified, the contract is considered to be for an unspecified time)

For certain employment contracts laws and collective agreements may provide for other requisite conditions to be discussed by the parties upon the conclusion of such a contract (agreement on the duration of the contract, the nature of seasonal work, etc.).
Upon the agreement of both parties, other conditions of the employment contract (probation periods, shorter working hours, the use of funds of the employer to train the employee and to improve his qualifications, as well as the manner and terms of the repayment of such funds, etc.) may be established, provided that employment laws do not prohibit such provisions.

In Latvia the mandatory provisions of the employment contract are as follows:

- the starting date of employment legal relationships;
- the expected duration of employment legal relationships (if the employment contract has been entered into for a specified period of time);
- the workplace (the fact that the employee may be employed in various places if the performance of the duties of employment is not provided for at a particular workplace);
- the occupation of the employee (trade, profession) and a general characterisation of the work contracted for;
- the amount of work remuneration and time of payment;
- the agreed daily or weekly working time;
- the length of the annual paid leave;
- the term for giving a notice of termination of the employment contract; and
- the provisions of the collective agreement and working procedure regulations to be applied to employment legal relationships.

In Estonia the mandatory provisions of the employment contract as follows:

- the work to be performed and its level of complexity;

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24 [24] [24] The Republic of Latvia Labour Law (comes into force 01.06.2002). Translation and Terminology Centre [http://www.ttc.lv/en/default-translations-lr.htm]
Republic of Lithuania Law on the Employment Contract (12.06.2001). Seimas of the Republic of Lithuania. [http://www3.lrs.lt/c-bin/eng/preps2?Condition1=151151&Condition2=]
Eesti Vabariigi Töölepingu seadus. (01.07.1992) [http://lex.andmevara.ee/estlex/kehtivad/AktDisplay.jsp?id=6668&akt_id=6668]

- the working time;
- the wages;
- the location of employment;
- the term of validity of a contract for a specified term (if the term is not included, the employment contract is considered to last for unspecified time);
- the date of commencement of employment.

It is the responsibility of the employer to guarantee that all conditions listed above are included

## Appendix 5 The Termination of labour contract in Latvia

The labour law (valid since 01.06.2002) regulates the termination of labour contracts.

Bases for termination of employment contract are following:

- the initiative of the employee;
- the initiative of the employer;
- expiry of the term of the employment contract;
- agreement between employee and employer;
- requests by third parties;
- death of an employer.

**General procedure** for termination of the employment contract: The advance notice for the termination of the contract has to be written and given to the other party well in advance as required in the law (different notice period may be determined with the employment contract or with the collective agreement). By agreement of an employee and employer an employment contract may-be terminated at the initiative of the employee also before expiry of the time period for a notice of termination. The fixed-term employment contract terminates on the day of the expiry.

**General sanctions to employers**.

1. upon the **illegal termination of the contract** on the initiative of the employer: employee has the right to demand in the court the notice of termination to be invalid, where after he will be reinstated to his work and will be paid average earnings for the whole period of forced absence. The same payment is maid when the court at the request of the employee terminates the employment legal relationship.
2. upon the **delay with the reinstatement of an employee to according to court decision –** The employee shall be paid the average earnings for the whole period of delay from the date of proclamation of the judgement until the day of its execution.
3. upon the **delay with final settlement**: If employment legal relationships have terminated and work remuneration has not been paid in good time due to the fault of the employer, the employer has the duty to compensate for losses caused to the employee

## Appendix 6 The Termination of employment contract in Lithuania

The Law on the Employment Contract regulates the termination of employment contracts.

Bases for the termination of employment contract are following:

- agreement between the parties;
- expiry of the term;
- upon the application of the employee;
- upon the initiative of the employer or at the will of the employer;
- the request of third parties (e.g. termination of contract with under age persons due to the demand of their parents)
- for state or local authority officials the violation of the obligations that demand to declare property and income, prohibit from being employed elsewhere or being the owner of personal enterprise

**General procedure** for termination of the employment contract: The advance notice have to be given in written form. The notice period varies according to bases for termination of employment contract and its length may also be changed with employment contract or collective agreement. Upon continuation of the employment relationship after expiry of the term for advance notice, the parties shall not unilaterally terminate the fixed-term contract employment contract.
Employers who are planning to dismiss within 30 days a group of employees (10 pr more in enterprises with more than 100 people, more than 10 % in enterprises with more than 100 people) must notify the labour exchanges and local governments of such plans 3 month in advance. Local governments may postpone the dismissal for up to 6 weeks.

**General sanctions to employers**.

1. **The delay with final settlements on the employers' fault**: The employee has the right to be paid an average wage for delay in payment, but not to exceeding the period of three months following the day of dismissal.
2. **Illegal termination of contract on the** initiative of the employer: employee has the right to demand reinstatement to his last employment and payment of his wages for the entire period of enforced absence from work or of the unpaid amounts of his last average wage for the period he had to work for lower remuneration. The employee may waive the reinstatement and then the court may adjudge to the employer compensation in the amount of up to 12 average monthly wages. If employment contract is terminated during the period of temporary disability or vacation, the first working day after the vacation period or period of temporary disability shall be considered the day of termination of the contract. The employee shall be paid wages at a double rate as well as disability benefits and holiday pay for the period during which the termination of the employment contract is postponed.

# Appendix 7 The Termination of Labour Contract in Estonia

## General Provisions

The Employment Contracts Act regulates the termination of labour contracts.

Bases for termination of employment contract are following:

- agreement of parties;
- expiry of the term;
- the initiative of the employee;
- the initiative of the employer;
- the request of third parties;
- circumstances which are independent of the parties.

**General procedure** for termination of employment contract: The advance notice of the termination of the contract has to be written and expressed unconditionally. In the consent of the other party the written notice may be waived. Upon continuation of an employment relationship after expiry of a term for advance notice, the parties shall not unilaterally terminate the employment contract on the basis of previously presented application.
The entry regarding the term, reason and benefits concerning the termination of contract is made into the employment contract and the term also into the record book (the reason is mentioned if the employee requires). The employer is obliged to return an employee's employment record book and pay the final settlement on the date of termination of contract. If employee has refused to take the record book and payment, the record book has to be returned upon the request of the employee and payment of final settlement has to be made within five days after the request.
Sole entrepreneurs have to register termination of an employment contract with the local labour inspector during the week following the termination.

## General sanctions to employers

1. upon the **illegal termination of contract** on the initiative of the employer: Employee has the right to demand reinstatement of his position, the change of the reason he was dismissed and payment of his average wage for the period he was compelled to miss the work. If the employee waives the reinstatement employer has to pay the compensation in the amount of the employee's six months' average wage.
2. upon the **delay of return of the employment record book and the delay with final settlement**: Employee has the right to get average wage for the every day the return of the record book was delayed. The compensation for delaying the final settlement has to be the sum of average daily wage of the employee for every day delayed, but not more than one month's average wage of the employee.
3. upon the **violation of the notice period**: An employer who releases an employee without his written consent prior to the term for advance notice must pay compensation in the amount of the employees' average daily wage for every working day short of the term of advance notice.

# Appendix 8 The calculation of index measuring the restrictions of dismissals for regular contracts [a]

| | | Procedural inconveniences | | Notice and severance pay for no-fault individual dismissals by tenure categories | | | | | | Difficulty of dismissal | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Notice period after | | | Severance pay after | | | | | | |
| | | Procedures | Delay to start a notice | 9 months | 4 years | 20 years | 9 months | 4 years | 20 years | Definition of unfair dismissal | Probation period | Unfair dismissal compensation at 20 years of tenure | Extent of reinstatement |
| **Measure in scale 0…6** | **Latvia** | 2 | 0 | 3 | 2 | 1 | 2 | 2 | 2 | 4 | 5 | 1 | 6 |
| | **Lithuania** | 2 | 0 | 6 | 4 | 2 | 6 | 6 | 2 | 2 | 5 | 2 | 6 |
| | **Estonia** | 4 | 0 | 6 | 4 | 2 | 4 | 3 | 2 | 4 | 4 | 1 | 6 |
| Share in factor 1 (procedural inconveniencies) | | 0.3 | 0.28 | 0.02 | 0.02 | 0.02 | 0 | 0 | 0 | 0.25 | 0.01 | 0.13 | 0.02 |
| Share in factor 2 (direct firing costs) | | 0.02 | 0 | 0.02 | 0.02 | 0.02 | 0.41 | 0.41 | 0.41 | 0.01 | 0.06 | 0.11 | 0.37 |
| Share in factor 3 (notice and probation period) | | 0.02 | 0 | 0.44 | 0.44 | 0.44 | 0.01 | 0.01 | 0.01 | 0.05 | 0.4 | 0.08 | 0 |

| | Latvia | Lithuania | Estonia | Share in aggregate measure |
|---|---|---|---|---|
| Factor1 | 1.94 | 1.61 | 2.57 | 0.44 |
| Factor2 | 3.57 | 4.79 | 4.00 | 0.3 |
| Factor3 | 3.22 | 4.11 | 3.75 | 0.26 |
| Aggregate measure | 2.76 | 3.21 | 3.31 | |

[a] The above measures are estimated in the scale 0…6. Thereafter these are weighted according to their weights in there factors (“procedural inconveniences”, “direct costs of dismissal”, “notice and probation period”). Finally all three factors are weighted and summed into an aggregate indicator that measures how strict is the termination of unspecified term employment contracts. The weights of individual measures in the factors are found by using factor analysis and data from OECD countries; see Nicoletti 2000 (pp. 40-54). The procedures for calculating the scales are given in the same source (see pp. 58-59, 71-72).

# Appendix 9 The calculation of index measuring the legal restrictions on using fixed term employment contract

| | | Fixed term contracts | | | Temporary work agency (TWA) employment | | |
|---|---|---|---|---|---|---|---|
| | | Valid cases other than the usual objective | Maximum number of successive contracts | Maximum cumulated duration | Type of work for which TWA is legal | Restrictions on number of renewals | Maximum cumulated duration |
| **Measure in scale 0…6** | **Latvia** | 4 | 0 | 3 | 3 | 2 | 2 |
| | **Lithuania** | 4 | 0 | 1 | 3 | 2 | 1 |
| | **Estonia** | 4 | 0 | 1 | 4.5 | 2 | 1 |
| Share in factor 1 (“procedures”) | | 0.24 | 0.22 | 0 | 0.24 | 0.22 | 0.07 |
| Share in factor 2 (“maximum duration”) | | 0.06 | 0.12 | 0.35 | 0.1 | 0.08 | 0.29 |

| Measure | Country | | | Share in aggregate measure |
|---|---|---|---|---|
| | Latvia | Lithuania | Estonia | |
| Factor1 | 2.26 | 2.19 | 2.55 | 0.6 |
| Factor2 | 2.33 | 1.34 | 1.49 | 0.4 |
| Aggregate measure | 2.29 | 1.85 | 2.13 | |

| Index | Country | | | Average of the Baltic States | Average of European Union (1998)[c] | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Latvia | Lithuania | Estonia | | | Germany | United Kingdom | France | Italy |
| Regular contracts | 2.76 | 3.21 | 3.31 | 3.09 | 2.4 | 3.0 | 0.1 | 2.5 | 3.0 |
| Fixed term contracts | 2.29 | 1.85 | 2.13 | 2.09 | 2.3 | 2.5 | 0.3 | 3.7 | 3.6 |
| Average[b] | 2.52 | 2.53 | 2.72 | 2.59 | 2.4 | 2.8 | 0.2 | 3.1 | 3.3 |

[c] See Nicoletti 2000 (pp. 87). The average of the European Union is the simple average of 14 member countries.
[b] The average is here a simple average of the indexes for regular contracts and fixed term contracts.

# Appendix 10 Number of participants in different Estonian, Latvian and Lithuanian labour market programmes

## Table 1. Number of participants in different Estonian labour market programmes, 1995-2001

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **Registered job-seekers a year (total)** | **77 294** | **93 649** | **85 890** | **81 638** | **105 782** | **120 921** | **136 831** |
| **1. Passive measures** | **39 789** | **44 421** | **46 679** | **48 428** | **63 610** | **67 412** | **70438** |
| Recipients of unemployment benefit | 39 789 | 44 421 | 46 679 | 48 428 | 63 610 | 67 412 | 70438 |
| **2. Active measures** | **16 130** | **14 228** | **13 552** | **12 243** | **11 366** | **12 929** | **11 149** |
| Participants in employment training | 9 809 | 9 343 | 8 241 | 7 956 | 7 027 | 8 150 | 10 233 |
| Employed with subsidies to employer | 121 | 249 | 216 | 136 | 265 | 189 | 366 |
| Employed with subsidies to start a business | 459 | 456 | 434 | 380 | 433 | 413 | 425 |
| Participants in community placement | 5 741 | 4 089 | 4 661 | 3 771 | 3 667 | 4 177 | 125 |
| **Participants in active measures, % of registered job-seekers** | **20,9** | **15,2** | **15,8** | **15,0** | **10,7** | **10,7** | **8,2** |

Source: Estonian Labour Market Board

## Table 2. Number of participants in different labour market programmes in Lithuania, 1995-2001

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **1. Passive measures** | | | | | | | |
| Recipients of unemployment benefit (in thousands) | 82.3 | 68.3 | 58.2 | 53.9 | 65.0 | 77.2 | 63.5 |
| **As % of registered job-seekers** | **38.5** | **37.2** | **30.1** | **26.4** | **26.6** | **30.0** | **25.4** |
| **2. Active measures (in thousands)** | **32.7** | **40.9** | **52.3** | **71.4** | **76.1** | **86.3** | **106.6** |
| Of them (in %): | | | | | | | |
| Creation of new jobs | 4.6 | 3.2 | 3.1 | 2.1 | 1.7 | 1.2 | 1.6 |
| Participants in employment training | 43.3 | 30.3 | 27.6 | 22.6 | 16.6 | 13.6 | 18.4 |
| Job clubs | 19.1 | 32.5 | 36.1 | 35.9 | 43.4 | 49.1 | 44.0 |
| Public works | 31.5 | 26.4 | 23.5 | 30.1 | 30.6 | 31.1 | 32.5 |
| Supported works | - | 6.0 | 9.3 | 7.6 | 5.6 | 2.9 | 3.6 |
| Start own business | 1.7 | 1.4 | 0.3 | 0.2 | 0.07 | 0.05 | 0.06 |

Source: Lithuanian Labour Exchange

## Table 3. Number of participants in different labour market programmes in Latvia, 1995-2001

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| **1. Passive measures** | | | | | | | |
| Recipients of unemployment benefit (in thousands) | 27.0 | 28.7 | 30.9 | 30.7 | 47.7 | 39.8 | 37.9 |
| ***As % of registered job-seekers*** | ***32.9*** | ***35.6*** | ***28.4*** | ***37.9*** | ***40.1*** | ***40.0*** | ***40.6*** |

Source: State Employment Service; Ministry of Welfare (Social Report 2001). The data on active measures was not available.

# Appendix 11 Factors influencing labour movement[25]

Migration research identifies a series of factors that appear to influence labour migration. They can promote or restrain migration, and depending on whether they emanate from the source or destination country they can be "pull" or "push" factors. They are often difficult to quantify and interact in complex ways, rendering any precise forecasting very difficult.

**Income gap**

The wage gap is a key factor. Because a migrant lives in the country of employment, an assessment of the income gap needs to take into account the different and usually higher cost of living as well as additional costs associated with migration, such as housing, travel, etc. Also, (s)he compares the present job or job opportunities with the job (s)he may obtain in the other country. In another country, (s)he may not be employed at the same level, or may not find a job at all, or the spouse may have to give up a job. A certain minimum family income gap is normally required to trigger migration. The speed of approximation of wage levels is a key determinant in any labour migration forecast.

Table 1. GDP and wage level in selected CEE countries

| Country | PPP-GDP per capita, in % of 15 EU | Gross wages and salaries, in % of 15 EU |
|---|---|---|
| Bulgaria | 21 | 6 |
| Romania | 20 | 9 |
| Lithuania | 24 | 13 |
| Latvia | 26 | 10 |
| Estonia | 28 | 14 |
| Hungary | 40 | 15 |
| Czech Republic | 47 | 18 |
| Slovenia | 64 | 46 |

Source: Boeri and Brücker, 2000

If we observe the latest available statistics in about wage differentials, then we can see how far are Baltic States and some other CEE countries from EU average level (see table at page 53). According to Boeri and Brücker it will take for Estonia around 16-18 years to catch up low income level member states of EU, for Latvia the predicted period is even longer 23-25 years and for Lithuania 34-35 years.

So the income difference will remain as main pull factor of migration. According to survey launched in 2000 by Estonian poll firm Saar Poll, around 90% of respondents saw income increase as the main incentive to go to work abroad.

**Labour market situation**

The supply of and demand for migrant labour are generally considered to be important factors. A high level of unemployment in the country of origin can push migration. However, importantly, a high level of unemployment in the country of destination can also have a strong effect, deterring work-seeking immigration.

If we look average unemployment rates in Baltic States and in other candidate countries, then in all three Baltic States unemployment rates are almost two times higher compared with EU average. In 2000 average

[25] The groups of factors influencing labour movement is presented according to the structure of factors elaborated in the EC Information Note (EC, 2001)

unemployment rate of EU was around 8 while in Estonia, Latvia and Lithuania they were 13,5%, 14,4% and 15,9% respectively.

In the short run, the economic cycle causes shortages and surpluses in different parts of the labour market that cannot easily be absorbed by the local labour force, leading to "import" and "export" of labour. Even in the presence of high unemployment, there may be labour shortages in specific sectors that exert a pull effect on labour migrants with the right skills. In the absence of free movement, such pressures may show up in illegal work or into less restricted channels such as self-employment or the importation of services.

**Demand for services**

The movement of persons for the provision of services, which includes also the posting of workers, follows a different logic than that of labour migration as it is not the worker who takes the initiative but a company seeking entry to a foreign market. It is provoked by market demand for services rather than labour. The subcontracting of services to other businesses is driven by factors of cost (e.g. in construction) or skill (e.g. business services or IT sector) rather than, for instance, individuals perceiving a wealth gap.

Recent example in Europe was Germany who was looking from East European countries IT specialists. Those kind of recruiting activities are important pulling factor of brain drain. But also it could be affect movement of low paid blue-collar workers who are invited by host country to seasonal agriculture works.

**Proximity**

Distance is not a crucial factor for the traditional migrant. In the case of the candidate countries, most labour migration is thought to be non-permanent, for periods of a few months to several years, during which people maintain links with their home country. A survey by the Saar Poll in 2000 revealed that only 4,0% of potential migrants is interested in permanent emigration in Estonia. 7,9% of them would choose to work a few years abroad, 17% would choose to work a few months and 19,9% would prefer commuting, seasonal and casual work. Geographical proximity could matter of course, 33% of Estonians would prefer Finland 19,3% would choose Germany and 16% Sweden. For Latvia and Lithuania most likely the preferred destination country is Germany. This is proved also by current migration statistics.

**Tradition and networks**

Some candidate countries have an emigration tradition.[26] Both surveys and recent data indicate that permanent emigration remains primarily directed overseas. Despite proximity, candidate country nationals still account for a small share of total emigration towards the EU during the last decade. The existing larger communities of foreigners in EU member states have mostly come about in connection with the existence of former colonies and/or of deliberate foreign recruitment schemes (from non-communist countries) in the post-war period. At the same time, temporary work-related migration from the candidate countries is directed mostly to EU countries; presumably, it substitutes to a certain extent for traditional emigration.

[26] As major past emigration waves were often linked to periods of political turmoil or economic hardship, it is doubtful how much predictive value they have in the case of accession to the EU.

There is empirical evidence that family, or national or ethnic networks are an important factor, i.e. existing immigrants tend to attract more immigrants from the same origin. However, concentrations of candidate country nationals in EU member states that could lead to network effects exist only in a few cases (e.g. possibly concentrations of Polish nationals in parts of Germany). It is not likely that Baltic migrants in EU counties will attract extra inflow of migrants. At least in the case of Estonia old Estonian communities in Europe (in Sweden for instance) consist of mostly elder persons, young generation is quite well assimilated with local community. Maybe in the case of Lithuania relatively strong and large community in US could be such a pulling factor of migration.

**Ethnic and political problems**

Ethnic and political problems generate emigration, rather than short-term job-related migration. This factor would appear to be the case in Latvia and Estonia where Russians tend to more migrate then native people. According to above cited survey of Saar Poll the probability of migration of Russians is two times higher then similar probability of Estonians.

**Cultural and linguistic barriers**

Socio-psychological and cultural factors play a major role in taking the decision to work abroad, especially for a longer period. The need to learn another language is typically a great obstacle for many people. Desire and deeds differ considerably, as most people can see opportunities but are too risk-averse to pursue them. The mobility of labour is rather limited, often already within the same country, where linguistic and cultural differences do not exist. The case of German reunification is interesting in this respect. A survey conducted in 1991 found that 36% of eastern Germans intended to move to western Germany. In the end, only 5% of those people actually moved within 2 years following the poll. In addition, 0.4% of those not intending to move eventually did move Identification with the sub-regional level and familiarity or identity with the small community act against labour mobility. On the other hand, given our common history, the cultural divide between the EU15 and the candidate countries is not deep, especially among countries with a common border. Also, geographical proximity and a high educational level have implied a more widespread knowledge of the major EU languages among candidate country migrants compared to migrants from more distant countries.

It was already explained that the most popular country for Estonians is Finland. If we look from our surveys how many persons have done some preliminary investigations about future possibilities to work abroad, then we can see that the number is very small only 10% have made some preliminary work. 64% said that they speak only two languages. For younger generation this is mostly English and for middle (over 30) age and older generation it is mostly Russian. 73% of potential migrants have very poor information about possibilities to work abroad.

**Expectations**

Good economic expectations in the potential migrant's own country reduce the propensity to migrate.[27] Accession itself, or the prospect of it, may have an important influence on expectations. EU accession-induced

[27] In a number of candidate countries, robust economic growth can be observed already today.

growth prospects in Spain and Portugal are sometimes cited as one of the explanations for the low subsequent emigration.