



## **WP4**

# **How to achieve complementarity between economic and social cohesion in the labour market?**

## **Policy Note**

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This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 290657

Human capital is one of the keys to competitive advantage as a major determinant of both productivity and wages and macro-level outcomes like economic growth and employment. Labour markets and education might facilitate social inclusion playing a vital role in the development processes of countries and regions; they also reveal important aspects of social differentiation, social exclusion and barriers in exploiting the regional and country-wide development potential that needs to be addressed by policy.

In WP 4, we (i) analysed the labour market developments in CEECs; (ii) we tried to identify and explain the shortcomings of policy-making related to employment in fostering social cohesion in the CEECs, but also in fostering the competitiveness of their economies; and (iii) examined the impact of education policies and reforms in education and training systems upon skill formation. The key findings and policy recommendations of the research are summarized in the following.

### **Main messages**

- A severe constraint on the efficient use of the labour resource in most of the CEE countries is the low level of labour supply of men. A combination of high spending on Public Employment Services (PES) and strict monitoring of job search yield high job search intensity, irrespective of the coverage of registration requirements. This is an effective strategy to the extent that high search intensity yields high reemployment rate.
- There is no good labour market policy without the public administration in general being effective. A higher capacity, better selected, better trained, better-motivated civil service can be expected to contribute to improving policy making quality.
- The problem of massive unskilled unemployment, a common and distinctive feature of CEE labour markets needs to be addressed. Better schools, more adult training, deepening civil integration, targeted programs and subsidies may help to ease unskilled unemployment.
- Participation in adult education is substantially lower in CEE countries than in Western and Northern Europe. Training participation is positively associated not only with education, but also with basic skills. The weaker basic skills play a role in the CEE-EU15 training gap.
- The deterioration of the situation in the labour market in the course of the economic crisis did not change considerably the relative structure of labour transitions and the relative position of disadvantaged groups in the CEE New EU Member States. Young aged persons and low educated are in a disproportionately severe situation having to face lower employment stability and longer spells of unemployment. Investments in education and life-long learning are necessary to be expanded.

- International student achievement data indicate weaker basic skills in most of the CEE countries compared to Western and Northern countries.
- The transition countries as a group need to invest more in the quality of primary and secondary education, which in turn implies that they must also invest more in tertiary, especially undergraduate, education so as to improve teacher quality and the evaluation and monitoring of the overall education system.
- The quality of higher education, especially at the level of graduate studies, is weaker than at the European top universities. The number of Ph.D. graduates in science, math, computing and engineering disciplines also remains insufficient for building up a modern science-intensive industry in cohesion economies. CEE economies need clear macro-regional division of labour in higher education and public R&D that would allow different universities and public research institutes to cover collectively cutting edge science and technology.

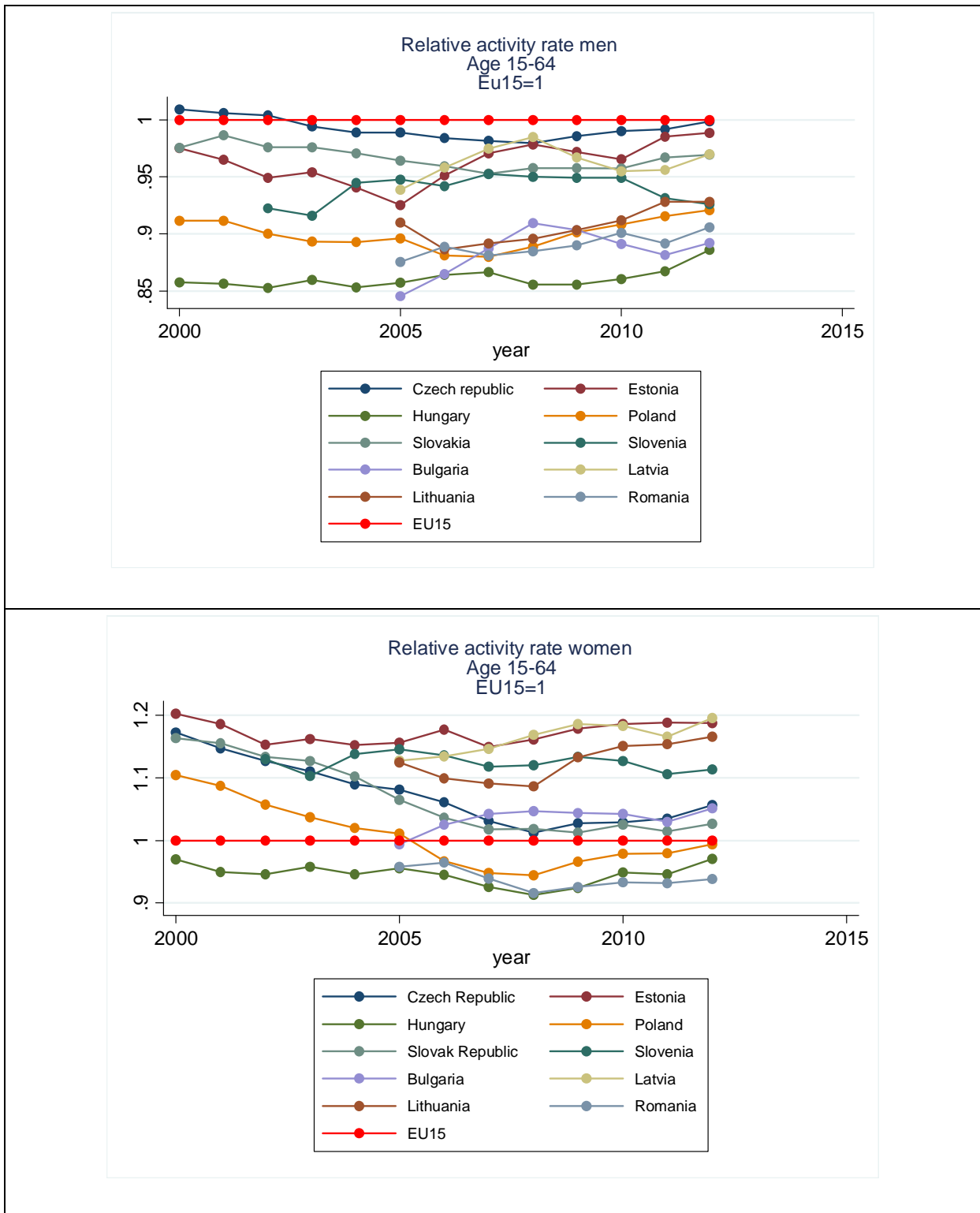
## **Improving labour market and activation policies**

A severe constraint on the efficient use of the labour resource in most of the CEE countries is the low level of labour supply of men. Activity rates of men are well below the EU15 average for all CEE countries; the only exception being the Czech Republic (*Figure 1*).

Aggregate labour demand, as well as the demand structure, changed during the economic transition in post-socialist new member states and managing the adjustment continues to pose a challenge to their underdeveloped public administrations.

Unemployment benefit schemes in the CEE countries are characterised by high initial replacement rates (dropping remarkably in the first year of entitlement), limitations in terms of their benefit level and duration, low coverage and restricted access. Moreover, the role of Public Employment Services (PES) and the range of available services are not very developed with limited monitoring or obligations to participate in activation strategies. While unemployment assistance is very uncommon in the CEE countries – with the exception of Estonia, Latvia and Hungary - the unemployed can draw on substantial means-tested income support provided by housing and social benefits (*Vidovic, 2013*)

**Figure 1**  
**Relative activity rates by gender in CEE countries (EU15=1)**



Source: Vidovic (2013) Based on EU LFS data

Throughout the past decade, there have been numerous changes in the unemployment insurance schemes in the CEE countries (*Table 1*). The revisions of the unemployment schemes,

especially the tightening of the eligibility criteria, but also active labour market policy measures contributed to a reduction in the share of unemployment benefit recipients in most CEE countries in the past two decades.

**Table 1**

**Major changes in the unemployment benefits systems in the new EU Member States 2001-2012**

	Unemployment insurance (UI)	Unemployment Assistance (UA)	Social Assistance (SA)
Country			
Bulgaria	2000,2004, 2007,2009, 2010	Absent	Absent
Czech Republic	2004, 2007, 2012, 2012	Absent	No significant change
Estonia	2007, 2009	2009	No significant change
Hungary	2005, 2011	2005, 2011	No significant change
Latvia	2010	2002, 2010	2009
Lithuania	2005, 2008	Absent	2009
Poland	2003, 2008	Absent	2004
Romania	2002, 2004, 2007, 2008, 2009, 2010	Absent	2012
Slovakia	2003, 2004	Absent	2003
Slovenia	2006, 2010	Removed in 2006	2010

Source: Vidovic, 2013. Based on Eurofound, 2012.

In the CEEs expenditures on both passive and active labour market policy measures relative to the GDP, have been below the EU-15 level. In 2012, the latest year for which data are available, expenditures on labour market policies as a percent of GDP was the lowest in Romania (0.29 %) and the highest in Hungary (1.14 %) among CEE countries, while the respective value in the EU-15 was about 2 percent. Over the crisis period, CEEs used for financing ALMPs primary funds provided by the European Union, the European Social Fund – ESF in particular. About the cost-effectiveness of ALMPs in the CEE countries improve the outflows to employment and contribute to a reduction in the unemployment rates. However, the impacts vary by interventions applied and by countries.

Policymakers in Central and Eastern European countries have taken various approaches to the activation of non-employed persons, and while there has been a move towards stricter eligibility criteria and a larger emphasis on jobseekers’ obligations since the year 2000, large differences in policies persist. In broad terms, the behavioural conditions for the access to unemployment benefits follow Western European standards in all the CEECs, but with much variation in the details of activation rules and in the implementation as well ( *further details see in Csillag – Samu- Scharle, 2013*).

Our result on the effect of various activation approaches on selected measures of job search are in line with earlier research in old member states and confirm the effectiveness of a consistently

strict approach to activating the non-employed population and also point to synergies between certain policy elements. A combination of high spending on Public Employment Services (PES) and strict monitoring of job search yield high search intensity, irrespective of the coverage of registration requirements. This is an effective strategy to the extent that high search intensity yields high reemployment rates. At the other extreme, limited registration requirements and low spending on PES yield low search activity, even if job search monitoring is strict

In countries that opted for no/or lenient activation (Bulgaria, Czech Republic, Hungary, Poland), the first step towards activation should be an increase in the coverage of registration, rather than a tightening of job search monitoring or increased spending on Public Employment Services (PES). For those countries that combine low spending on PES with limited registration coverage and strict monitoring, an increase in PES spending may be effective, especially if they can prevent outflows into other welfare benefits. Expanding the coverage of registration without increasing PES spending would take them to the Slovak and Slovene strategy, which we found to yield mixed results. For Slovenia and Slovakia, the obvious choice is to increase PES spending, but it would take further research to evaluate the cost effectiveness of this choice.

With the help of a one-dimensional measure, the quality of labour market related decision-making and policy design was analysed (*Váradi, 2014*). The results show that there is no good labour market policy without the public administration in general being effective. Differences in whether left-wing or right-wing parties ruled governments and whether the country is more or less open to trade do not seem to matter that much in the CEE region. A higher capacity, better selected, better trained, better-motivated civil service can be expected to contribute to improving policy making quality in a field that is by its nature highly dependent on those qualities for the success of its measures.

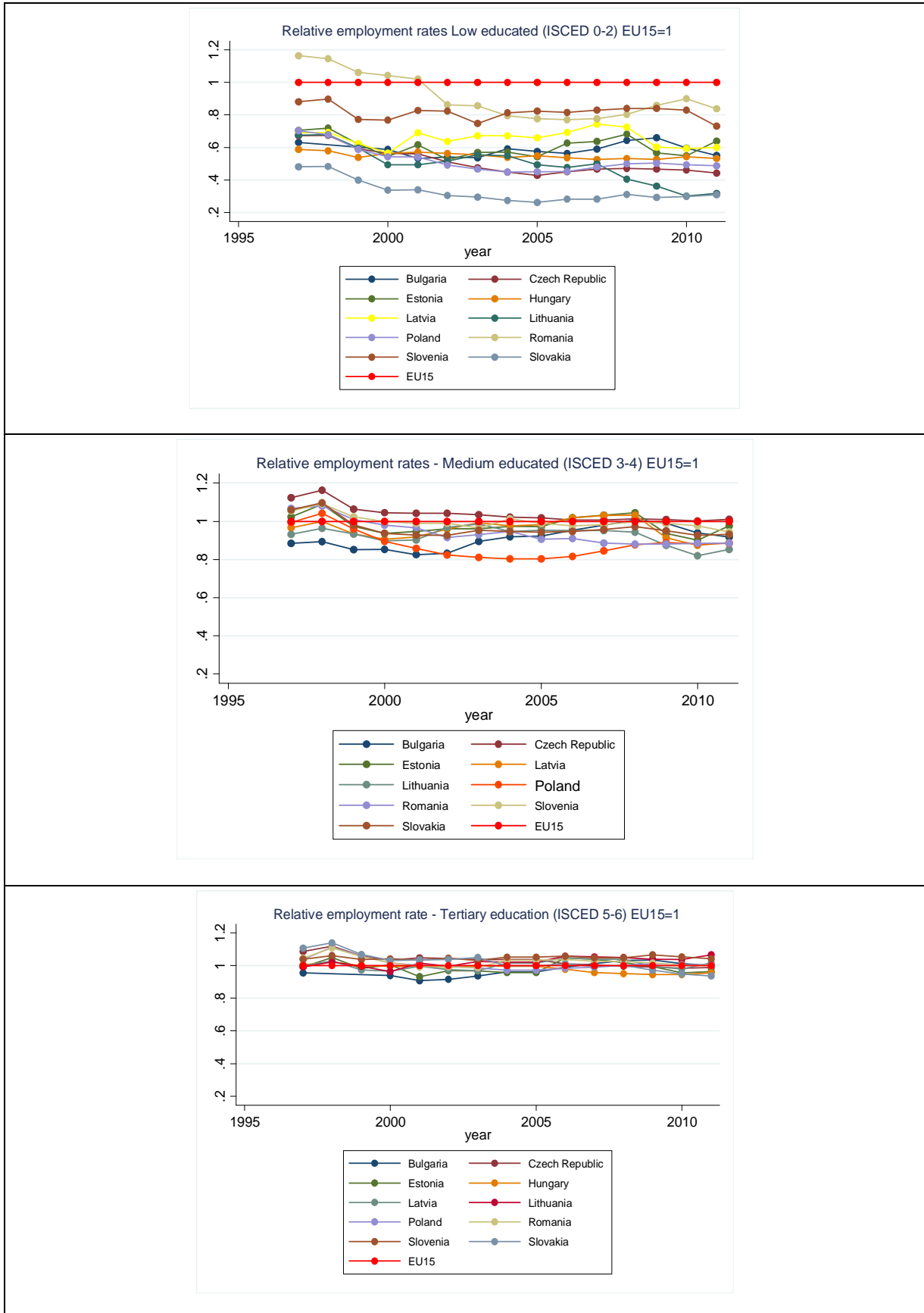
## **Improving employment prospects for the low educated**

Policy should be targeted at the points where the region's countries jointly fail. The problem of massive unskilled unemployment, a common and distinctive feature of CEE labour markets needs to be addressed.

The employment rate of those whose highest educational attainment is tertiary education is similar in the CEEs to average employment rate of the EU15. Employment rates of those who have upper secondary education is slightly lower, while there is a very large and persistent lag in the employment rates of the undereducated (less than upper secondary education) (*Figure 2*).

Figure 2

Relative employment rates by educational attainment in CEE countries (EU15=1)



Source: Based on EU LFS data

The gap between high and low educated people in terms of job prospects is nowhere as wide within the EU and the OECD as in the post-socialist countries of Central and Eastern Europe. East-West mean differential in the unskilled employment to population ratios is significantly larger than the within-region variance. (*Figure 3*).

In the course of the crisis low educated, were hit hardest by the economic downturn depicted by a substantial drop in employment stability, increased flows into unemployment and sunken probability to find a job again if being unemployed. The probability, to move from education to employment, dropped strongest for this group, and the persistence of unemployment rose for this group stronger than for medium educated (*See Leitner, - Stehrer, 2014*).

Although the share of the unskilled in the labour force is lower than the EU15 average, the region's persistent failure to provide its unskilled population with work poses the risk of destructive social fragmentation, erosion of the legal and market institutions and slower growth.

The research found that two important drivers of unskilled employment are absent in the post-communist EU member states.

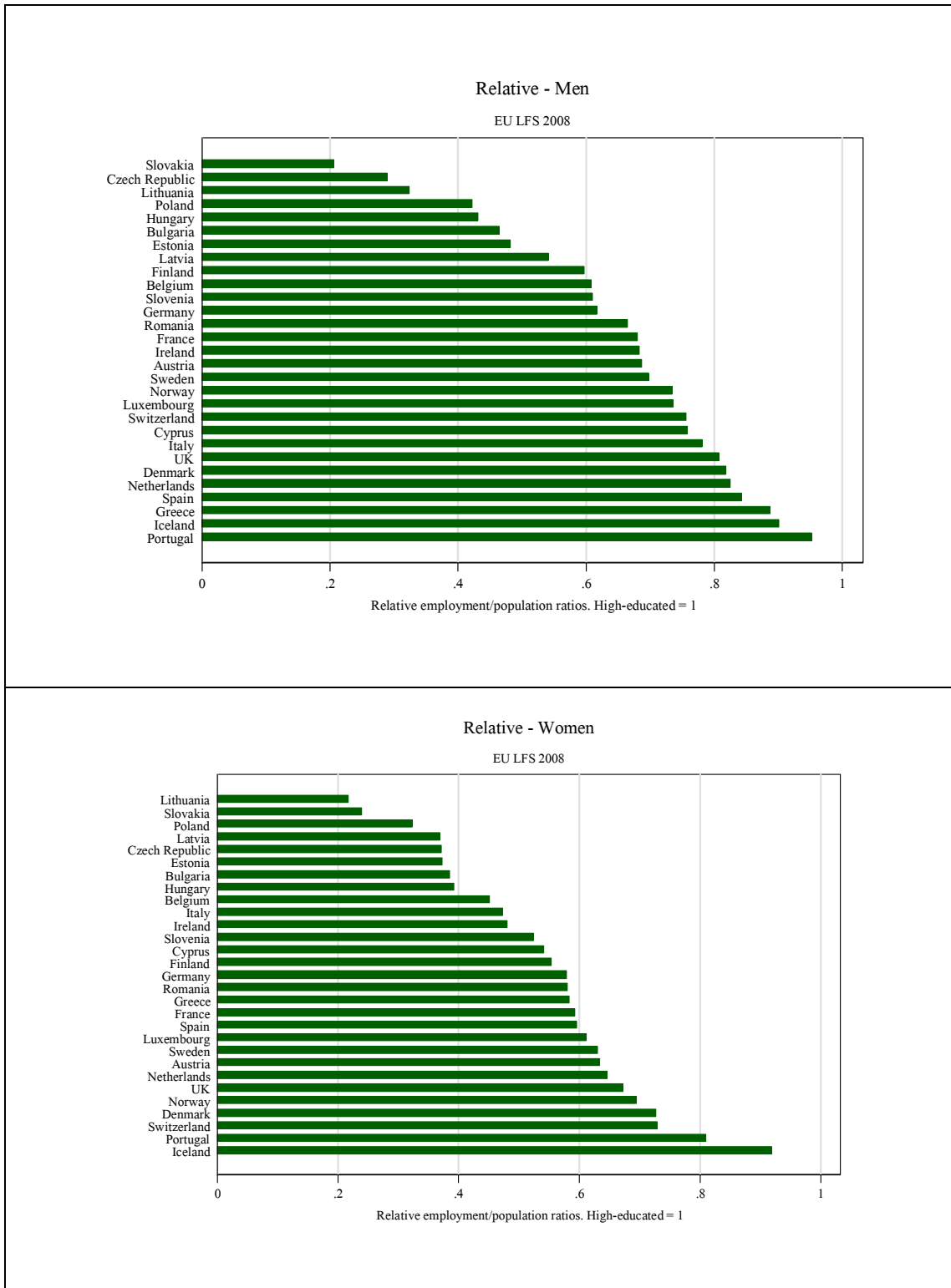
First, unlike in Southern Europe, the low educated cannot rely on the traditional small-firm sector that had been eliminated under state socialism and could not recover since then. Second, dissimilar to Northern Europe, low educated people infrequently participate in adult training and civil activities, which could develop their cognitive and non-cognitive skills. These conditions severely restrict the number of jobs available for them while their exclusion from work limits their links to the rest of the society and both non-employment and social isolation constrain them in skill formation (*See Köllö, 2013*).

Better schools, more adult training, deepening civil integration and efforts to create a feedback from work to skills by bringing the unskilled 'in from the cold' with the help of targeted programs and subsidies may help to ease unskilled unemployment.



Figure 3

The relative levels of unskilled (ISCED 0-2) employment (High educated=1)



Source: Köllő, 2013. Based on EULFS data

Note: the data relate to the population aged 15-64 excluding students and persons older than 35, who never worked. Unskilled stands for those classified as ISCED 0-2

## Improving participation in adult education

Participation in adult education, especially in non-formal adult education is substantially lower in CEE countries than in western and northern Europe, both for the employed, unemployed and inactive population. Composition effects do not explain these differences in terms of individual characteristics, firm size and economic sector. (*Figure 4*)

Training participation is always positively associated not only with education, but also with basic skills (literacy, numeracy), as better skills make training more profitable and/or less costly. The weaker basic skills of those with a low or medium level of education in CEE countries are likely to play a role in the CEE-EU15 training gap (*See Hermann, 2014*)

Amongst the lack of mechanisms providing the low educated with a 'second chance,' the quality of education bears special importance. Primary and vocational schools should equip the students with basic competencies that enable them to participate in formal adult training and learn informally after leaving the school system.

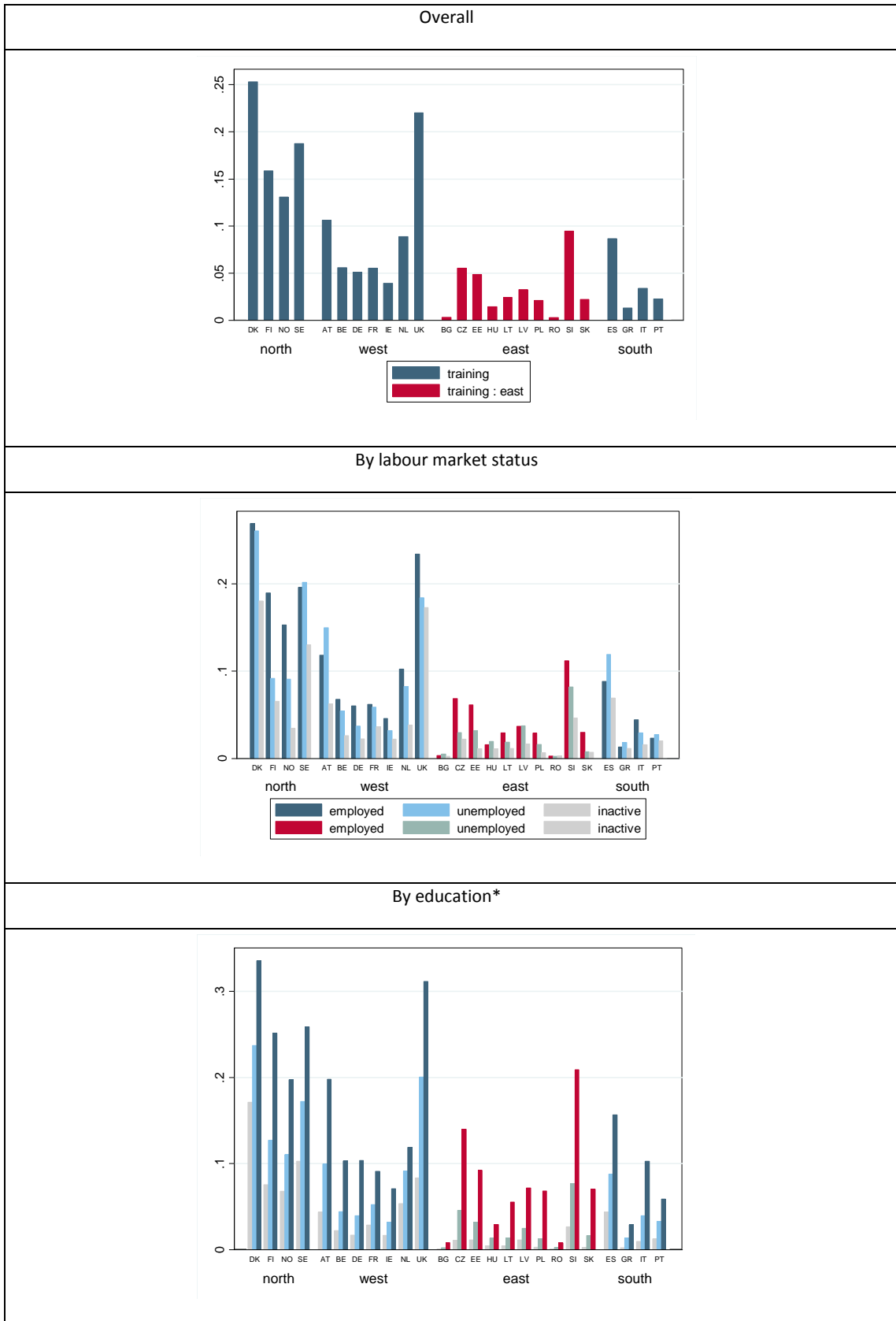
The regulation of employer-provided training is worth to be reconsidered in order to alleviate possible market failures and to induce firms to increase long-term investment in the human capital of their employees. The employer-employee contracts seem to be of particular importance.

Carefully designed and implemented training programs for the unemployed can have positive effects both on employment prospects and social inclusion of the low skilled. However, as positive employment effects cannot be taken for granted, thorough economic evaluation studies of these, both ex-ante and ex-post, are indispensable.

As far as the training gap is related to the lack of basic skills, this provides another argument for policies aimed at increasing the quality of public education. If basic skills are important for adult training, vocational training tracks, providing specific skills at the expense of general skills, may be beneficial for the employment of the young, but prove to be a disadvantage later in the life-cycle of workers.

Figure 4

Training participation rates overall by labour market status and by education in EU countries



Source: Hermann, 2014. Based on EU-LFS, 2004-2011 data

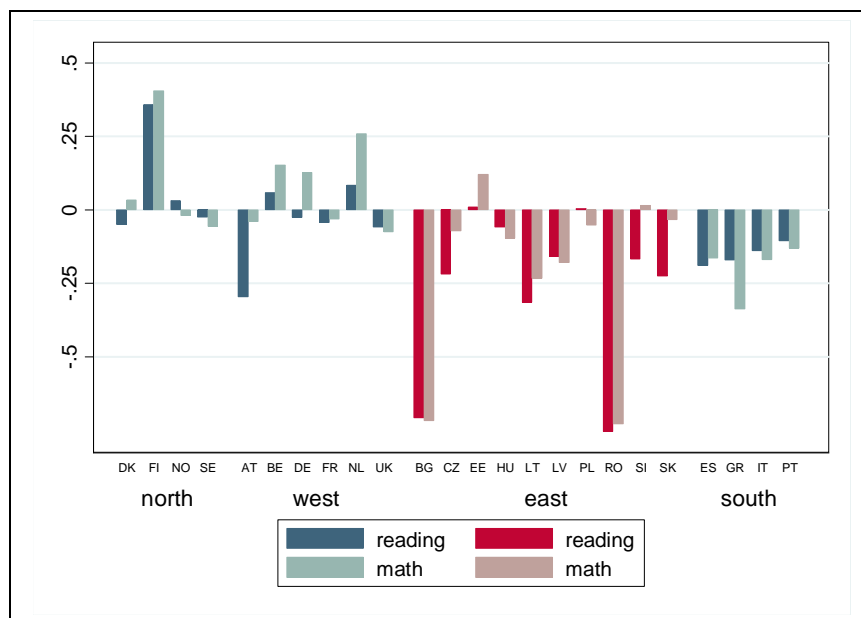
\* From left to right: low, middle, high

## Improving the public educational system

The transition countries as a group need to invest more in the quality of primary and secondary education, which in turn implies that they must also invest more in tertiary, especially undergraduate, education so as to improve teacher quality and the evaluation and monitoring of the overall education system.

International student achievement data indicate weaker basic skills in most of the CEE countries compared to Western and Northern countries (*Figure 5.*)

**Figure 5**  
**Standardised student test scores, 15 years old – PISA 2009**

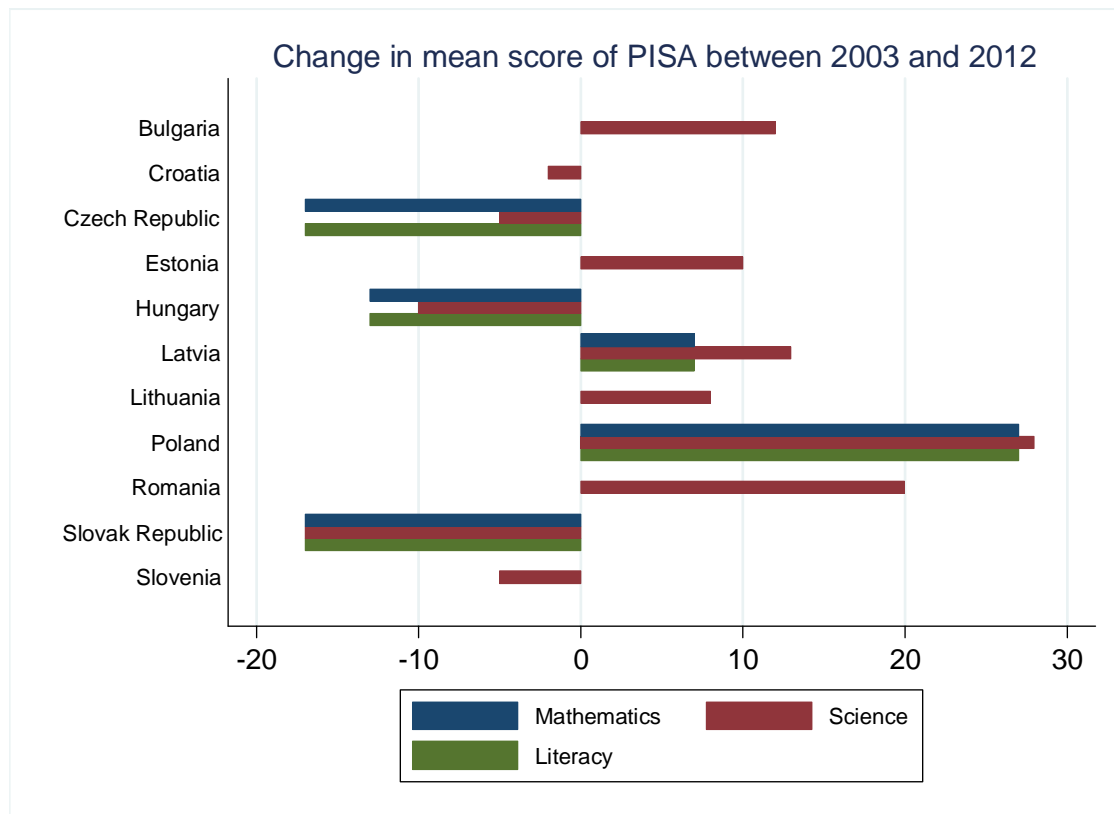


Source: Hermann, 2014

Some CEE countries (Poland, Latvia) succeeded in improving students' performance in all skill categories – literacy, numeracy, science – while students' performance deteriorated significantly in other CEE countries (*Figure 6*)

The case of Poland suggests that with the help of well-designed educational reforms significant improvements can be achieved in student's performance. Poland restructured its basic education by postponing for one year the choice between general or vocational curriculum at the secondary level. Curricula reform accompanied this structural change. A core curriculum was developed that aimed at providing schools with extensive autonomy and responsibility. A system of examinations and tests at the end of primary and lower secondary was also introduced. These reforms might have contributed to the improvement of student's performance (*Herbst-Wojciuk, 2014*).

**Figure 6**  
**Changes in PISA score in CEE countries**



Source: Varga, 2014. Based on OECD PISA data

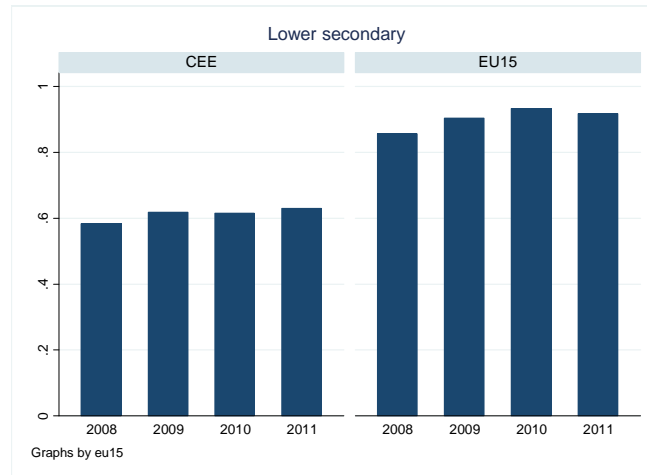
Comprehensive reforms of the educational system and avoiding early student selection may have a positive impact on students' performance. It is worth reconsidering to defer early student selection to upper secondary education while reinforcing comprehensive schooling in countries where early tracking regime is applied (Bulgaria, the Czech Republic, Hungary, and the Slovak Republic and Slovenia). These countries could decrease inequality by rising the tracking age.

In addition, it is important to balance decentralisation/local autonomy with resource accountability to ensure support to schools. School autonomy needs a well-functioning environment to generate positive effects; a dysfunctional setting can be harmful in.

Teacher quality is a key determinant of student's performance. Higher pay induces more able graduates into the profession. In most CEE countries, teacher salaries are low in comparison with other graduate salaries and the difference between teacher salaries and other graduate salaries is much larger than in the EU15 countries (Figure 7).

**Figure 7**

**Average teacher salaries compared to average graduate salaries a by country groups 2008-2011**



Source: Varga, (2014). Based on OECD data

Increasing teacher quality is crucial for improving students' performance. Higher wages attract better quality teachers to the profession. Increasing teachers' salaries will help to attract better quality teachers. Nevertheless teacher quality can be raised only gradually. Countries with a stock of low-quality teachers cannot just shift up the wage of all teachers and expect the quality of teachers to improve. The stock of low-quality teachers can be changed only gradually even if the quality of new recruits to the profession improves.

The research found that overall salary increases may have adverse effects as they give an incentive to low-quality teachers to remain in the profession and put a financial burden on school systems. Improving the salary advancement, in-service training to improve the stock of existing teachers and improving incentive mechanisms would have an impact on teacher quality and students' performance (Varga,2014).

All CEE countries provide a mix of tracks in their secondary schooling: general secondary schools, a higher level of vocational secondary schools (technical schools or vocational secondary schools) and a lower level of vocational schools including apprenticeship programs. Research findings suggest that there are advantages to targeted vocational training programmes that are not school-based. Workplace-based training seems to enhance early labour market employment of the non-college bound youth. Hence, the support of workplace-based training during compulsory vocational education may have a positive effect, unless the acquisition of basic skills is hindered (Horn, 2013).

## Reducing the Roma/non-Roma school achievement gap

Large ethnic disparities are among the most severe impediments to social cohesion. In Central and Eastern Europe, the most disadvantaged ethnic minority is the Roma minority. The Roma/Non-Roma school achievement gap is substantial in all countries (*Table 2*).

**Table 2**

### The percentage of 20 to 24 years old with upper secondary education ( Roma and non-Roma)

Country	Percentage of 20 to 24 years old with secondary education <sup>a</sup>		National average (3)	The ethnic gap	
	UNDP survey, 2011 Roma (1)	Non-Roma (2)		Non-Roma vs. Roma (2) – (1)	National avg. vs. Roma (3) – (1)
Bulgaria	20.7	65.2	42.3	44.5	21.6
Czech Republic	30.1	76.1	79.0	46.0	49.0
Croatia	19.7	72.8	42.0	53.1	22.4
Hungary	21.3	62.0	70.4	40.7	49.2
Slovakia	18.1	48.0	42.5	30.0	24.4
Romania	11.5	67.1	42.2	55.7	30.7

<sup>a</sup> Upper secondary education (ISCED level 2) or vocational education .

Source: Kertesi-Kézdi, 2014

Our research found that the Roma/non-Roma school achievement gap is primarily due to poverty and associated disadvantages at home and school. Aside from the phenomenon of school segregation, none of the causes of the achievement gap requires a social policy intervention directed at the Roma minority in particular. The academic deficits and social exclusion of disadvantaged children, both Roma and non-Roma, should be remedied by universal and colour-blind policies. Interventions should clearly aim to prevent extreme poverty in families with children; income and family support policies should pay particular attention to struggling social groups. Societies cannot always rise to the challenge of significantly alleviating poverty or preventing the emergence of mass poverty among families with children. However, targeted policy interventions can successfully reduce the skills gap of children who grow up in poverty and marginalized social groups. The perhaps most promising method of preventing failures at school is to provide children with an environment

(objects, tools, activities, services) that facilitates their cognitive and linguistic development, and to promote complementary parenting methods.

## **Improving the quality of higher education**

The achievement of the 3% research intensity target established in the European Unions' Lisbon and EU 2020 strategies presupposes a substantial structural change toward a more science-intensive industry in the European cohesion regions. Contrastingly, these economies have demonstrated so far a relatively slow build-up of the science-intensive industry. The quality of higher education, especially at the level of graduate studies, is weaker than at the European top universities. The number of Ph.D. graduates in STEM disciplines also remains insufficient for building up a modern science-intensive industry in cohesion economies (*Tiits et al., 2014*)

The number of researchers employed by industry needs to increase significantly in cohesion economies to allow them to catch up with more science-intensive economies in Europe.

European small economies need a clear macro-regional division of labour in higher education and public R&D that would allow different universities and public research institutes to cover collectively the cutting edge science and technology. This will allow them to attract the very best mobile talents and to benefit from them. There might also be a need for joint venture capital facilities, or similar mechanisms, that allow for greater risk sharing in nurturing future emerging industries.

In setting a future policy agenda, we see benefits from the smart specialisation concept as it emphasizes, similarly to the innovation literature, the role of knowledge, technology and innovation in economic development and encourages careful priority setting. The key to success is to ensure that various policy makers and stakeholders are involved in the process and will have a good command of the latest developments in key emerging technologies and relevant industrial and market dynamics.



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