

ACTIVE LABOR MARKET POLICIES IN ROMANIA AND BULGARIA: AN EMPIRICAL EXAMINATION

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Abstract

Active labor market policies (ALMPs) have long been used to assist in structural adjustments and to prevent the jobless from getting ensnared in long-term unemployment. ALMPs are often used to help stop the dependency on public transfers, especially in recent years when countries have dealt with a global financial crisis and large public debt. The four main types of ALMPs have different ways of accomplishing the same objectives, chief among those reducing unemployment. As a result, ALMPs are often costly. There are two measures to determine the importance of ALMPs at the macro level: 1) the number of workers in an ALMP program as a share of the labor force; and 2) the public expenditures on ALMPs. This paper will focus on the second measure, public expenditures on ALMPs, to examine the importance of ALMPs in Romania and Bulgaria. The paper concludes with a discussion of the policy issues associated with ALMPs.

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1. Introduction

Active labor market policies (ALMPs), such as job search assistance, job training, and job creation through public works and subsidies, have long been used to assist in

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structural adjustments and to prevent the jobless from getting ensnared in long-term unemployment. ALMPs are also used in an attempt to ensure the unemployed maintain skills that are competitive on the labor market and keep wages stable. Should the unemployment period become long-term, workers' skills deteriorate, and job searches eventually end. Over time this creates increased risk of social marginalization and poverty. Therefore, ALMPs are an important economic policy strategy to bolster GDP, and used to help stop the dependency on public transfers. However, in recent years when countries have dealt with the global financial crisis and large public debts ALMPs have come under scrutiny for their cost-effectiveness.

The effectiveness of ALMPs in Europe have been examined as these policies are a vital component of the European Employment Strategy outlined in the Europe 2020 initiatives. For example, Kluve (2006) did a meta-analysis review of the effectiveness of ALMPs in Europe. He found that there are no distinct patterns, although services and sanctions have a positive impact, job training exhibited mixed positive results, and public sector hiring has negative employment effects.

The literature on the evaluation of ALMPs is extensive. However, the research on ALMPs in Eastern European economies is much less widespread. In particular, there is little research on ALMPs in Romania and Bulgaria. This paper seeks to fill this gap and contribute to the existing literature by describing ALMPs used in Romania and Bulgaria and by evaluating the effects of those policies.

The rest of this paper is organized as follows. Section two presents the key literature on ALMPs. Section three presents the data and the analysis techniques, analyzes the data, evaluates, and compares the ALMPs in both countries. Section four concludes the paper with a discussion of the policy implication of ALMPs in Romania and Bulgaria.

2. Literature on ALMPs

An extensive literature exists on ALMPs. However, despite this rich literature, there is a dearth of research on the use and effectiveness of ALMPs in Romania and Bulgaria. This section presents just some of the more relevant literature on ALMPs.

Alvarez and Veracierto (1999) built for the U.S. a general equilibrium model to estimate the aggregate effects and welfare concerns of labor-market policies and institutions such as minimum wages, unemployment insurance, and unions. They find that minimum wages have an extremely small aggregate effect, that higher rates of unionization increase the unemployment rate and substantially decrease welfare levels, that firing taxes reduce unemployment but have negative welfare effects, and that unemployment insurance increases the unemployment rate by increasing both the duration and incidence of unemployment.

Neumark and Wascher (2004) built on these findings by estimating the employment effects of changes in national minimum wages for seventeen OECD countries for the 1975-2000 time period. They found that minimum wages cause youth

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unemployment but with a large variation across countries. Those countries with subminimum wages for youths have smaller unemployment effects from those that do not. Further, they find that restrictive labor standards and higher unionization rates strengthen the effects of minimum wages, while employment protections laws and ALMPs can offset these effects. Finally, in those countries with the least regulated labor markets the negative employment effects of minimum wages are strongest.

Martin and Swank (2004) extended the research to the firm by using pooled time-series data on within and across-country spending on ALMPs and firm level survey data to model whether a social corporatist organization resulted in greater support and participation by employers in social policy formation. They found for Denmark and the U.K. that the coordination and centralization of employers and employer organizations are strongly correlated with shares of national income devoted to ALMPs. They also found that the degree of employer organization forms ALMP responses to deindustrialization and increases in unemployment.

Mortensen (2005) built a model of endogenous growth and unemployment for EU-28 to isolate the potential effects of employment protection and tax policies. He found that both policies increased unemployment and that employment protection adversely impacts the incentive to innovate.

Using data for twenty OECD countries, Dority and Fuess (2007) found that unemployment is not related to disinflation and that joblessness is significantly related to labor market institutions and that ALMPs have been successful in combating unemployment. Similarly, Estevão (2007) found that ALMPs have a positive effect on employment in fifteen industrial countries after controlling for institutional variables and country-specific effects. He also found that direct subsidies for job creation were most effective, but that greater expenditure on ALMPs results in lower wages and that if these policies are financed through increased labor income taxation, there will be negative effects on labor utilization.

van den Berg, Bergemann, and Caliendo (2008) extended these findings and developed a method to relate self-reported perceived treatment rates and behavioral outcomes of job searches, such as the reservation wage, to each other. They used job search theory to develop predictions for the German ALMP program. They found that the system creates a negative ex ante effect on the reservation wage and a positive effect on the effort of the job search.

Fialová and Schneider (2008) broadened the scope of this research and examined the role of labor market institutions in explaining different labor market development in European countries. In particular they were interested in both the 'old' and 'new' EU member states and estimated the impact of labor market institutions on unemployment, long-term unemployment, employment, and activity rates. They found that high taxes, stricter employment protection, and a higher minimum wage increase unemployment and decrease the activity rate, while ALMPs reduce unemployment. They also found that there is a difference in the institutional effects between the 'old' and 'new' EU members.

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Focusing on European women, Bergemann and van den Berg (2008) examined the effects of ALMPs on individual labor market outcomes like employment and income for unemployed adult females. They found that ALMPs have a positive impact on employment for women and that these effects are larger than for men in economies with a low female labor force participation. The policy that had the greatest impact was skill-training programs.

Kahn (2010) also examined some of these same policies by doing a comparative analysis of labor market policies of OECD countries and their expected impacts on outcomes such as inequality, unemployment, and temporary employment. He found that many of the policies provide income insurance by reducing the impact of market forces on wages, mandating severance pay or creating barriers against firing workers, providing unemployment benefits, and providing training or public employment through ALMPs. He also examined the impacts of labor market policies and institutions. He found that labor market interventions cause low levels of wage inequality and high levels of job security for workers, which in turn causes unemployment for those seeking jobs and temporary workers.

2.1 ALMPs in Bulgaria

A World Bank (1999) report found that the Bulgarian government's emphasis on ALMPs aimed at the youth, the long-term unemployed, and ethnic minorities is positive. The report also found that Bulgaria should evaluate existing programs based on their outcomes and cost-effectiveness.

The World Bank did another report in 2002 finding that Bulgaria employs a variety of ALMPs with the following as the main programs: temporary employment, training with non-guaranteed jobs, training with guaranteed jobs, subsidized employment, employment associations, and self-employment programs. These programs were found to have a positive net impact, improving the employment prospects of some participant groups.

Spevacek (2009) did a review of studies that examined the effects of ALMPs in Central and Eastern European and Commonwealth of Independent States countries. She found that for Bulgaria small business assistance had the greatest positive impact and public works the lowest positive impact of ALMPs used in the country to reduce unemployment. She also found skills training and wage subsidies to have positive impacts. Employment services were found to have mixed results as they had a positive overall impact but a non-positive impact for men.

In contrast, the European Commission (2011) found that poor labor market participation in Bulgaria is in part due to insufficient provisions of properly targeted and tailored ALMPs. They found that the quality of and spending on ALMPs are low and that the coverage is limited with only 12% of jobseekers participating in programs. Lastly, they found that more individualized, better quality, region-based ALMPs would have a positive effect.

2.2 ALMPs in Romania

Extending the research to Romania, Rodriguez-Planas and Benus (2006) evaluated the effectiveness of four ALMPs (job (re)training, small business assistance, public employment, and employment and relocation services) implemented in Romania at the end of the 1990s. They found that job (re)training, small business assistance and employment and relocation services were effective in improving the economic outcomes of participants in the program and cost-beneficial from a societal perspective. On the other hand, public employment was found to damage the employment outlook for participants.

Rodriguez-Planas (2007) built on her previous findings by using survey data and matching methods to evaluate the effectiveness of employment services and small-business assistance programs in Romania. She found that, on average, employment services are more successful than a small-business assistance program, although employment services are effective for workers with little access to informal search networks, and small-business assistance programs work better for less-qualified workers and those in rural areas. She also found an educational divide as employment services are more effective for workers without a high-school degree and small-business assistance programs work better for more educated workers.

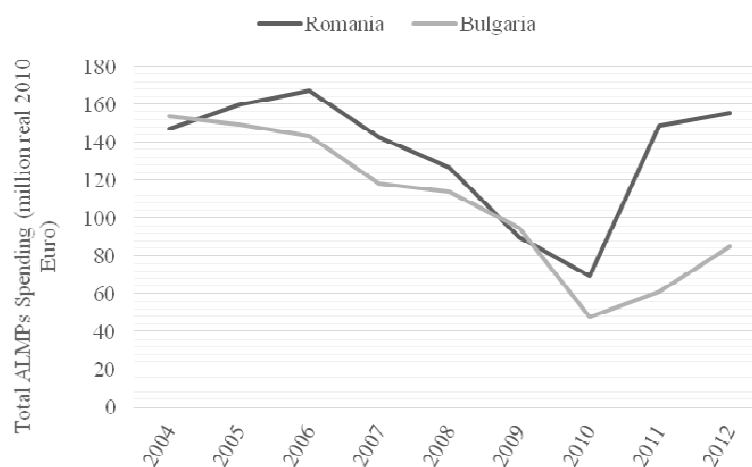
Bocean (2008) extended this area of research and developed a theoretical and empirical analysis of ALMPs in Romania for the 2000-2005 time period. He found that subsidized jobs are the most effective platform to decrease unemployment, while job training and temporary public works jobs in community service also have a positive impact. However, although unemployment decreased Bocean found these policies not cost-effective and that they are subject to diminishing returns as the number of employed increased.

As stated previously, Spevacek (2009) did a review of the literature examining the effects of ALMPs in Central and Eastern European and Commonwealth of Independent States countries. She found for Romania that small business assistance programs are the most effective in reducing cyclical unemployment, while public works programs are effective in diminishing short-term cyclical unemployment. She concluded that ALMPs such as employment services, skills training, and wage subsidies had inconclusive results, though tending towards a non-positive impact.

3. Data Description and Analysis

The data used in this research project were obtained from the European Commission Eurostat labour market policy database. This data provides information on public labor market interventions, defined as “Public interventions in the labour market aimed at reaching its efficient function and correcting disequilibria and which can be distinguished from other general employment policy interventions in that they act selectively to favour particular groups in the labour market.” (European Commission Eurostat)

ALMPs are implemented to encourage employment opportunities for those seeking jobs. However, these programs can be very expensive. As a result, one measure of how important reducing unemployment and maintaining a low unemployment rate is to a country is the public expenditures on ALMPs. Figure 1 illustrates the total spending on ALMPs by Romania and Bulgaria. As seen by Figure 1, the structural changes to the Romanian and Bulgarian economies lead to a substantial decrease in spending on ALMPs from 2006 to 2010. However, the financial crisis of 2008 resulted in a massive increase in spending on ALMPs.



Source of data: EUROSTAT

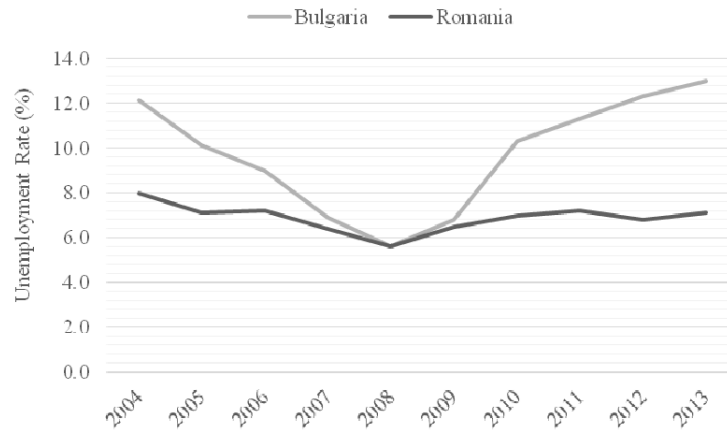
Figure 1. Total Spending on ALMPs for Bulgaria and Romania (2004-2012)

Corresponding with the increase in spending on ALMPs is the unemployment rate in Romania and Bulgaria. As shown in Figure 2, the financial crisis that resulted in the increase in spending on ALMPs also lead to an increase in unemployment. However, of particular interest is that the aggressive approach that Romania took

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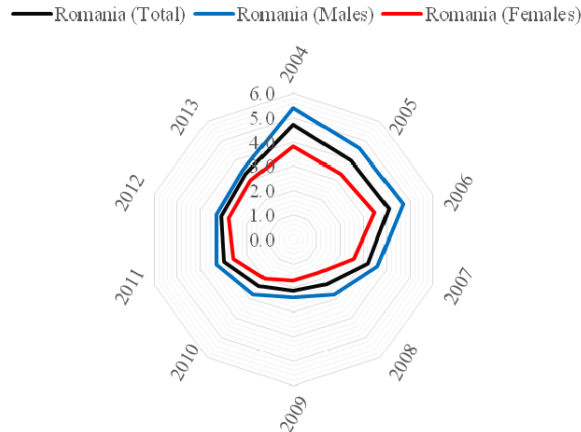
towards ALMPs lead to a subdued increase in the unemployment rate. In comparison, Bulgaria took a much less aggressive approach and the passive policies lead to an extensive increase in unemployment.



Source of data: EUROSTAT

Figure 2. Unemployment Rate for Bulgaria and Romania (2004-2012)

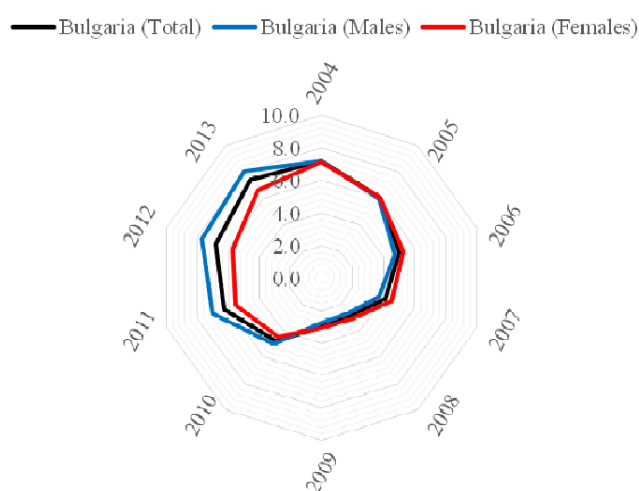
Also of interest is the long-term unemployment rate (LTU). LTU is a key indicator to determine how serious unemployment is and how effective ALMPs are.



Source of data: EUROSTAT

Figure 3. Long-term Unemployment, Total and by Gender: Romania

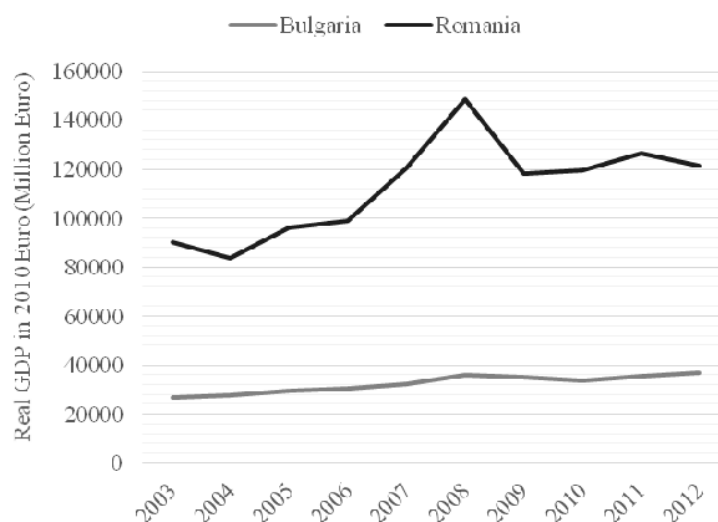
Figures 3 and 4 illustrate the LTU in Romania and Bulgaria. These figures illustrate several important findings. First, males in both countries were more adversely affected than females, although Bulgarian women have started experiencing a sharp upturn in LTU in 2013. Second, the investment in ALMPs, also substantiated by Figure 2, by the Romanian government helped to avoid a much more devastating blow to unemployment. In contrast, the lack of urgent action by the Bulgarian government resulted in a harsh increase in LTU.



Source of data: EUROSTAT

Figure 4. Long-term Unemployment, Total and by Gender: Bulgaria

However, while there is a clear correlation between ALMPs and unemployment statistics, the connection to GDP is not as clear, as shown in Figure 5. In particular, the Bulgarian economy experienced just a slight downturn from 2008 to 2010 before regaining their slow, but steady upward trend. Given the Bulgarian unemployment trends, this GDP result is surprising. However, one explanation is that there may be a fairly significant informal economy. On the other hand, the Romanian economy benefitted from the investment in ALMPs, experiencing a substantial economic downturn in 2008 and then stabilizing post 2009. The steadying of the economy corresponds with an initial aggressive approach to ALMPs. However, the results also suggest that had the Romanian government continued an aggressive approach, their economy would have continued on an upward trajectory rather than experiencing a small decrease from 2011 to 2012.



Source of data: EUROSTAT

Figure 5. Real GDP for Bulgaria and Romania (2004-2012)

4. Conclusions

ALMPs are an important economic tool to increase employment opportunities for the unemployed. Furthermore, they can also assist the economy in keeping the labor force up-to-date in their job skills. As this paper has shown, the use, or lack thereof, of ALMPs can have a substantial impact on economies. For example, Romania avoided a much worse economic downturn by aggressively investing and using ALMPs during the financial crisis of 2008 and thereafter. In contrast, the Bulgarian government took a much more passive approach to ALMPs and, as a result, the unemployment rate increased substantially during this time period. As evidence of these conclusions, several key indicators, such as the unemployment rate, the long-term unemployment rate, public spending on ALMPs, and GDP were explored. The data confirmed these conclusions and illustrated the effectiveness of ALMPs in these two economies.

There is not a substantial amount of literature on the use of ALMPs in Central and Eastern European Countries, particularly for Romania and Bulgaria. As a result, this paper is important as it fills a gap in the literature. Furthermore, these results can be used by policy-makers to illustrate to the populace the importance of public spending on ALMPs to stimulate the economy by avoiding high levels of unemployment and long-term unemployment.

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