

INQUIRY REGARDING THE SUSTAINABILITY OF ACTIVE LABOR MARKET POLICIES IN ROMANIA¹

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Abstract

Active labor market policies (ALMP) are often used to assist in structural adjustment, including change to information society, and to prevent the jobless from getting ensnared in long-term unemployment. ALMPs can help reduce dependency on public transfers, especially in recent years when countries have struggled maintaining financial sustainability due to the global financial crisis and large public debt, by assisting workers in finding jobs.

The main types of ALMPs have different ways of accomplishing the same objectives, chief among those reducing unemployment. As a result, ALMPs are frequently 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 as a percentage of GDP.

This paper will focus on the second measure, public expenditures on ALMPs as a percentage of GDP, to examine the importance of ALMPs in Romania, the financial sustainability of the public policies, and attempt to empirically illustrate how they impact the labor market. The paper concludes with a discussion of the policy issues associated with ALMPs in Romania.

Keywords: ALMP, labor market, Romania

JEL Classification: J08, J68

1. Introduction

Active labor market policies have been extensively used by many countries for decades in an attempt to improve the functioning of their individual labor markets. Typically this is done by government investment in human capital and enhancing labor mobility. As such, there are four primary types of ALMPs for the unemployed, those at risk of losing their job, and employed adults seeking to improve their employment situation: training; subsidized employment; public employment services; and activation (Boeri and van Ours, 2013). Training programs provide skill-based instruction to the unemployed and other priority groups to make them more employable. Subsidized employment provides monetary incentives for firms to hire targeted workers or to maintain their current staffing levels. Furthermore, there is monetary support for unemployed people seeking to develop their own business. Public employment services include placement services, job counseling, and assistance with job searches. Activation provides incentives for unemployed individuals to find employment through benefit reductions or by requiring the unemployed to attend employment counseling and apply for jobs and accepting suitable offers. Additionally, there may be obligations for unemployed individuals to attend job training and creation programs.

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However, for the purposes of this paper are considered the following types of ALMPs: (1) training, (2) employment incentives, (3) direct job creation, (4) start-up incentives, and (5) out-of-work maintenance and support. Training is as defined above. Employment incentives include subsidies and tax reductions from the government to employers for hiring workers. Direct job creation is the hiring of workers for public employment. Start-up incentives are subsidies and other incentives aimed at unemployed individuals entering self-employment. Lastly, out-of-work maintenance and support are transfer payments to the unemployed to sustain them during their period without employment so they can pay for every day expenses while performing their job search. The main objectives of these types of ALMPs are to reduce or eliminate disequilibrium in the labor market by encouraging vigorous job searches and hiring.

The effectiveness of ALMPs have come into question during and after the global financial crisis of 2008. ALMPs are very expensive. As a result, as country debt and deficits ballooned, the scrutiny on expenditures for ALMPs increased. However, ALMPs may not be a negative revenue source. Thus, the effectiveness of ALMPs must be considered. Two measures are used to explore the importance of ALMPs at a country level. First, by examining the number of workers receiving ALMP benefits as a share of the labor force and, second, by scrutinizing the money spent on ALMPs as a percentage of GDP (Boeri and van Ours, 2013).

One country that has taken a dynamic approach to ALMPs is Romania. The Romanian government used ALMPs extensively after the Revolution of 1989, sensing the urgency to assist the unemployed in the transition period from a planned economy to a market economy. During the centrally planned regime, human capital decreased as the labor force was required to work in jobs that did not properly value or utilize their skills. As a result, after the Revolution, the Romanian government quickly recognized the need to assist the population with social safety programs, including ALMPs to support unemployed and, perhaps, unemployable people. As reforms took place and the market economy matured ALMPs were scaled back until the Great Recession took hold.

The focus of this paper is to evaluate the effectiveness of ALMPs on reducing unemployment in Romania. In particular, using data from Eurostat for the years 2003 to 2012, the impact that ALMPs have had on unemployment rate, long-term unemployment rate of the active population, very long-term unemployment rate of the active population, and unemployment rate for those aged twenty-five or younger is examined.

The rest of the paper is structured as follows. The next section presents a selection of relevant findings from the literature on ALMPs. Section 3 provides a description of the data and an explanation of the techniques used to analyze the data. Section 4 presents the results of the analysis of the effectiveness of the use of ALMPs in Romania. Section 5 concludes the paper.

2. Some preliminary considerations

The impact of the Great Recession on developed countries was very traumatic; between 2007 and 2010 the unemployment rate in advanced economies increased from 5.4 percent to 8.3 percent, and by the end of 2012 it had declined to 8.0 percent prompting Blanchard and his colleagues (2014) to claim that the right motto is “protect workers, not jobs”. Despite the fact that in the E.U., member states offer a wide range of welfare arrangements to protect the unemployed, the general trend of the past two decades was towards an increasing commitment for ALMPs (Wulfgramm 2014). Empirical analysis comparing unemployment benefit generosity with a country’s commitment to ALMP, in order to alleviate the detrimental impact of unemployment on life satisfaction, has shown “that a generous passive labour market policy moderates the negative life satisfaction effect of unemployment to an impressive extent, while the positive effects of ALMP turn out to be less robust” (p. 259). According to another comparative analysis by Blanchard and collaborators (2014, 5)

The best model is the “Nordic” model—based on a medium to high degree of employment protection, on generous but conditional unemployment insurance, and on strong active labor market policies—which allows for reallocation while maintaining low unemployment.... These are surely caricatures, but the success of the Nordic countries in “protecting workers, not jobs” has led to the belief that the Nordic model, also termed the “flexicurity model,” is the direction to go to reform labor market institutions.

On a different level, the *threat* effect of ALMPs, meaning how the programs have as an indirect effect a behavioural change of unemployed people that makes them more eager to move away from unemployment, is investigated by Andersen (2013) who presents a detailed review of literature related to this topic. The focus is on developed countries (Scandinavian countries, Switzerland, U.K., Denmark, U.S. and Australia); the results are mixed and depend on factors such as business cycle, length of unemployment, country and gender of the unemployed.

The Beveridge curve illustrates the relationship between the number of people unemployed and the number of job vacancies in the economy. Bonthuis and collaborators (2013) analyze developments in Beveridge curves for all Euro area countries over 20 years, at both the aggregate level and on a disaggregated basis. Their results show a significant shift in the Euro area Beveridge curve since the onset of the Great Recession, but considerable heterogeneity at the country level suggesting that ALMPs aimed at upskilling and re-training of low-skilled workers would have a positive effect. For Romania, Lincaru (2010) uses the Beveridge curve to investigate regional mismatch tendencies.

Mitigating the effects of unemployment is even more demanding for transitional countries and developing countries than for developed countries. For example, Romania has a dual labour market with 30% of the labour force in agriculture (E.C., 2013) and 15% of total population labour migrants (Stan and Erne, 2014); those two groups play a buffer role (Bocean 2007) for employment decrease due to industry restructuring. Bocean (2007) presents an empirical analysis of eight types of ALMPs (vocational training courses; benefits allotted to the unemployed who take up employment before the period of entitlement to the unemployment benefit; employers' subsidization; stimulation of the labour force mobility; granting loans to SME's for new jobs creation; counselling and assistance services for starting up an independent activity or business; temporary employment in public works in community service and other active measures) for Romania between 2000 and 2005, before joining the EU. For that transitional period, subsidized jobs seem to have been the most effective program to decrease unemployment; also, labour market training and temporary public employment in community service had a positive impact.

Additionally, for CEE and CIS countries (including Romania), Spevacek (2009) presents a review of programs and analyzes the effectiveness of five types of ALMPs and concludes that the most attractive are employment services (such as job search assistance) and skills training programs. The relative effectiveness in Romania of employment services and small-business assistance programs is evaluated by Rodríguez-Planas (2007). The results show that employment services are, on average, more successful than a small-business assistance program. Extending this study, Rodríguez-Planas and Jacob (2010) estimate the effects of four ALMPs implemented in Romania in the late 1990s. Their results correspond to earlier findings in transition countries and show that training and retraining, self-employment assistance, and public employment and relocation services had success in improving participants' economic outcomes, while public employment appears detrimental for the employment prospects of its participants.

3. Data Description and Analytical Techniques

The data used in this paper were obtained from the Eurostat database (European Commission, 2015). The variables considered for analysis in this paper are listed in Table 1.

Table 1. List of variables considered for Romanian ALMP analysis

Variable Name	Variable Name
Activity rate for 15 to 24 year olds	Long-term unemployment rate of the active population
Activity rate for adults 20 to 64	Out-of-work maintenance and support as a percentage of GDP
Direct job creation as a percentage of GDP	Population
Employment services as a percentage of GDP	Start-up incentives as a percentage of GDP
GDP growth rate	Total active labor market spending as a percentage of GDP
GDP per capita	Training services as a percentage of GDP
Inflation	Unemployment rate
Job training as a percentage of GDP	Unemployment rate for those less than 25 years of age
Job vacancy rate	Very long-term unemployment rate for the active population

The following variables serve as independent variables in our analysis:

- ✓ Two *activity rate variables* are included as measures of labor force participation. These variables are expected to have a positive coefficient when used with unemployment variables as the dependent variable as there will be more people in the labor force.
- ✓ Both *GDP growth rate* and *GDP per capita* are included because increased economic activity should increase employment and lower unemployment. These variables are included to decipher whether ALMPs really work or whether an increase in economic activity causes a reduction in unemployment. Neither of these variables are found to be significant with the unemployment variables used as dependent variables. However, both GDP growth rate and GDP per capita would be expected to have a negative relationship with unemployment.
- ✓ *Inflation* is included because increased economic activity in an economy generally leads to increased inflationary pressure. Furthermore, the variable is included to determine if an expansion in monetary policy has a bigger impact on unemployment rather than ALMPs. Inflation, following the Phillips Curve, is expected to have a negative relationship with unemployment. However, inflation could have a positive coefficient with long-term unemployment depending on the skills of the labor force.
- ✓ The *job vacancy rate* is included to examine if there is a corresponding relationship between this variable, ALMPs, and unemployment. Job vacancy rate was used but found to be not significant in any of the models for unemployment.
- ✓ *Population* is included to examine whether increases or decreases in population in Romania impacts the unemployment rate either positively or negatively. Population is expected to have a positive relationship with the unemployment rate as the more people there are the more jobs that must be created in the economy.
- ✓ *ALMP variables* include direct job creation, employment services, job training, start-up incentives, training services, and total ALMP spending, all expressed as a percentage of GDP. Since ALMP expenditures are likely to increase as unemployment increases (Boone and van Ours, 2004), following Bocean (2007), the different types of ALMP expenditures are normalized as expenditures per unemployed person as a percentage of GDP per member of the labor force, as shown in Equation 1:

$$x_i = \frac{\frac{ALMP_i}{GDP}}{\frac{U}{N}} = \frac{\frac{ALMP_i}{GDP}}{\frac{UL}{LN}} = \frac{almp\%}{ul} \quad (1)$$

where $ALMP_i$ represents the various types of expenditures on active labor market policies, U it total employment, GDP is gross domestic product, N is the population, L is the labor force, $almp\%$ is each type of ALMP expenditure as a percentage of GDP, u is the unemployment rate, and l is the labor force participation rate.

The ALMP variables are all spending as a percentage of GDP in Romania: direct job creation, employment services, job training, out-of-work maintenance and support, start-up incentives, training services, and total ALMP. All the variables except for job training and out-of-work maintenance and support are expected to have negative coefficients as they are developed to reduce unemployment. However, job training and out-of-work maintenance and support are expected to have a positive coefficient, unless lagged for several periods, because job training takes time before a worker has acquired the skills to get a job and out-of-work maintenance and support can prolong unemployment spells as workers do not have to take the first job that they are offered because they have financial support from the government.

These ALMPs are widely used to reduce unemployment. Therefore, the following four unemployment variables are used as dependent variables. The *unemployment rate* is an obvious choice as a dependent variable since it is the leading indicator used for labor market performance. The *long-term unemployment rate* of the active population and the *very long-term unemployment rate* of the active population are also used as dependent variables to determine if ALMPs have an impact on the unemployment of those who have been seeking employment for an extended period and whose job skills may have deteriorated due to such an extended period without an occupation. Long-term unemployment is defined as a period of unemployment of one year or more, with the long-term unemployment rate is defined by Eurostat as the share of unemployed people without a job for twelve months or more in the total

number of active people in the labor market (European Commission, 2012). Very long-term unemployment is defined as a period of unemployment of two years or more, with the very long-term unemployment rate defined by Eurostat as the share of unemployed people without a job for 24 months or more in the total number of active people in the labor market (European Commission, 2012). ALMPs are developed primarily for this group of individuals so using these variables as dependent variables will allow for the impact of ALMPs to be determined. The last dependent variable considered is the *unemployment rate for those less than twenty-five years old*. This variable is examined to determine if there are ALMPs that specifically impact the problem of youth unemployment.

To examine these variables, ordinary least squares (OLS) linear regression analysis is used. OLS linear regression was used because the small sample size of the study does not allow for a proper time series analysis to be performed (Hyndman and Kostenko, 2007). All regression analyses performed in this paper account for heteroskedasticity using White's method to correct the standard errors. Furthermore, each of the models in this paper has been tested for serial correlation using the Breusch-Godfrey Serial Correlation LM test. If serial correlation was found, the problem was corrected by using lags. Therefore, the results presented in the next section are robust.

4. Results and Analysis

Figure 1 illustrates the evolution of the four unemployment rates over the period 2000-2013. The unemployment rate, long-term unemployment rate, and very long-term unemployment rate have declined slightly since 2000, although before the financial crisis in 2008 there was a substantial decrease, but unfortunately, subsequently an increase followed.

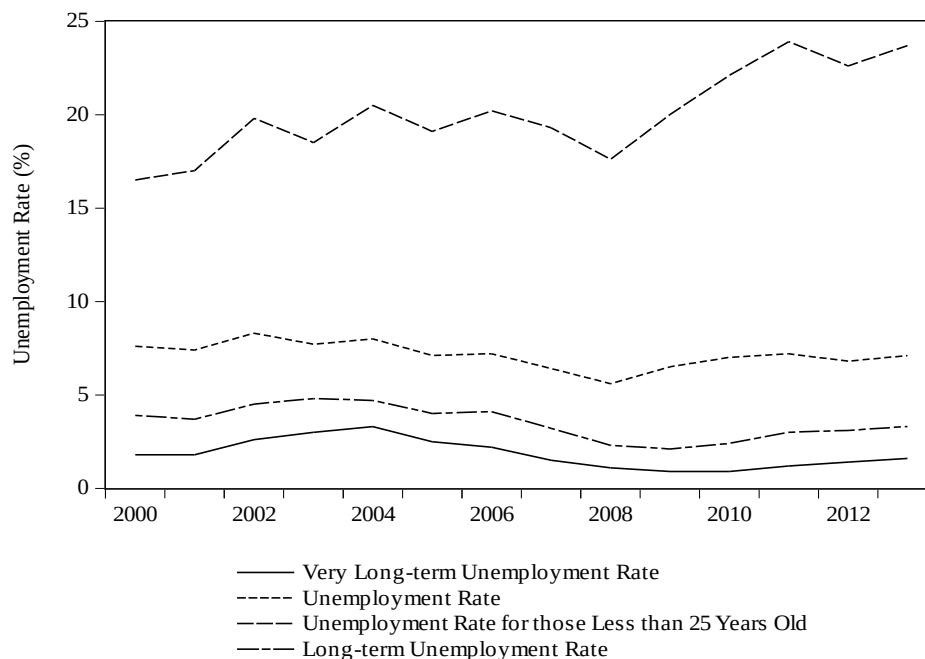
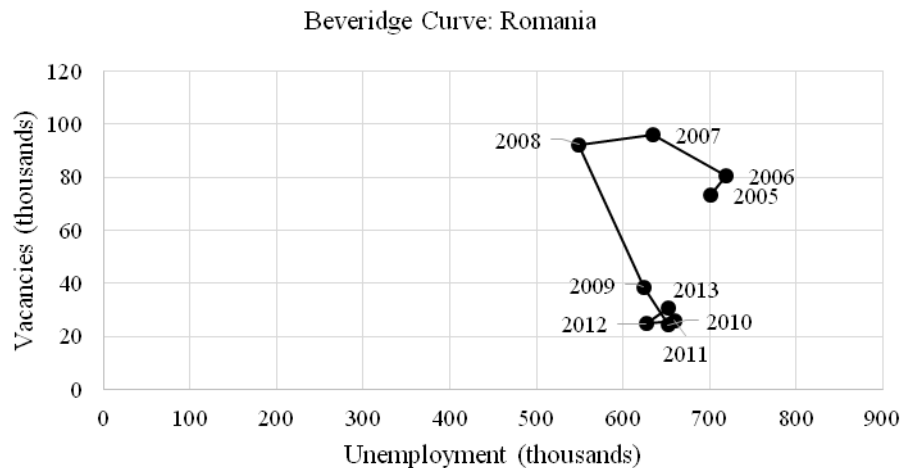


Figure 1. Unemployment rate in Romania, 2000 – 2013

However, youth unemployment, the unemployment rate for those less than 25, saw an increase over this same time period, getting larger with the financial crisis of 2008. The data suggests that employment that youth might obtain is temporary and likely low-paid service jobs. The data also shows that as the economy expands and contracts ~~that~~ the unemployment rate, long-term unemployment rate, and very long-term unemployment rates increase and decrease

by approximately the same amounts suggesting that employers are looking for workers across all spectrums of the labor force.

The Beveridge curve for Romania (Figure 2) shows that the number of vacancies in Romania has decreased substantially since 2008 while the number of unemployed has increased. The graph suggests that in 2008, after the beginning of the financial crisis, many firms in Romania reduced their workforce or ceased operations. Furthermore, the relatively small increase in the number of unemployed also suggests that people stopped looking for employment and left the labor force while some of the workers joined the informal labor market or left the country.



Source: Authors' analysis based of Eurostat data

Figure 2. The Beveridge curve for Romania (2005-2013)

Figure 3 presents the total spending and spending by types of ALMPs in Romania from 2003 to 2012.

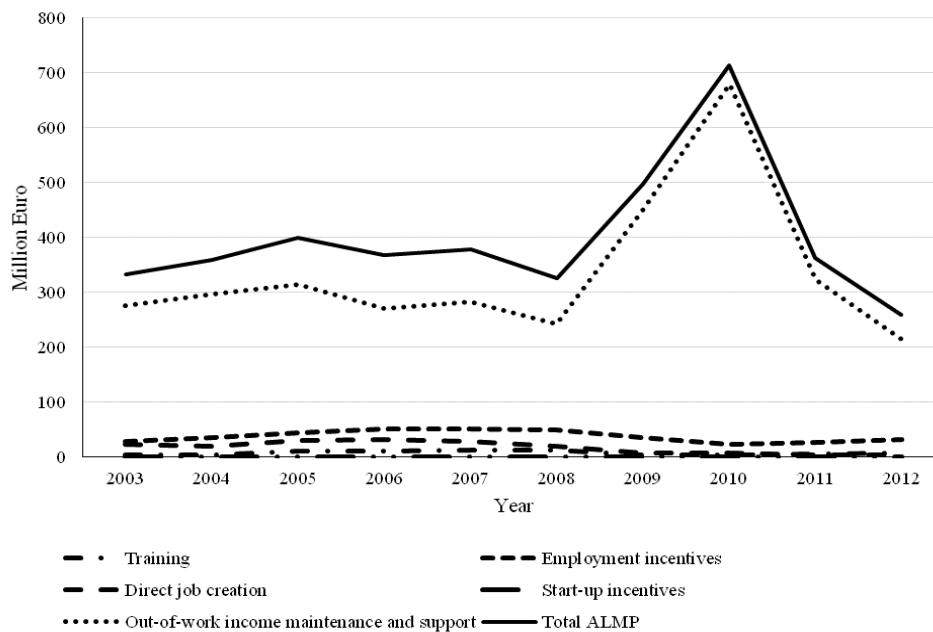


Figure 3. ALMP Spending in Romania 2003 – 2012

As shown in the graph, ALMP spending slightly decreased from 2003 to 2008. When the financial crisis hit in 2008 there was a corresponding increase in ALMP spending until 2011 when spending decreased to pre-crisis levels. After 2010 total ALMP spending decreased by more than one-half with out-of-work maintenance and support making up nearly all of that decrease. This change in spending suggests that the worst of the financial crisis was over as the government did not find it necessary to help boost the economy with unemployment payment benefits. Yet, unemployment lagged therefore, the government slightly increased spending on training and employment incentives.

As shown in Table 2, the use of ALMPs in Romania had both positive and negative impacts on unemployment.

Table 2. ALMPs and the Unemployment Rate

Dependent Variable: Unemployment Rate				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.696957	1.327329	1.278475	0.2483
Activity Rate 15-24	0.204985	0.037275	5.499279	0.0015
Employment Services	-3.302182	0.764874	-4.317292	0.0050
Job Creation	2.392062	0.847731	2.821721	0.0303
R-squared	0.903834			
Adjusted R-squared	0.855751			

The ALMP that has a large negative relationship with the unemployment rate is employment services. However, job creation, another ALMP possibility, was found to have a positive relationship with the unemployment rate, as does the activity rate for young people aged 15 to 24. One possible reason that job creation is found to increase unemployment is that this ALMP is generally targeted at the long-term unemployed and hard-to-place individuals. As a result, job creation would likely take several periods before there is reduction in unemployment. It was found that two lags are necessary before job creation has a negative impact on unemployment; however, the variable was not statistically significant in any model configuration. The positive coefficient for the activity rate for young people aged 15 to 24 is consistent because employers can hire young people at lower wages and as part-time or seasonal staff to fill their labor needs. Other ALMPs were tried in the model, however none other than those reported were statistically significant.

Given the results of ALMPs on overall unemployment, whether or not the policies would have an impact on long-term unemployment are examined next. First, the impact of ALMPs on long-term unemployment in the percentage of the population is considered. These results are provided in Table 3.

Table 3. ALMPs and Long-term Unemployment Active Population

Dependent Variable: Long-term Unemployment Active Population				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-84.14518	34.23022	-2.458213	0.0574
Population	0.004145	0.001595	2.598411	0.0483
Employment Services (-2)	-4.176534	0.893229	-4.675770	0.0055
Out-of-work Income Maintenance and Support (-1)	0.127282	0.058176	2.187889	0.0803
R-squared	0.734191			
Adjusted R-squared	0.574705			

In this case, two ALMP instruments were found to be statistically significant, employment services and out-of-work income maintenance and support. Additionally, population was found to be a statistically significant variable. As expected, population has a positive coefficient; the larger the population the greater the number of jobs that must be created in the economy to maintain a stable unemployment rate. Of the two ALMP mechanisms, employment services with a two period lag has a negative relationship with long-term unemployment and out-of-work income and support with a one period lag has a positive relationship. Both signs on the coefficients are as expected. Employment services should reduce long-term unemployment. Furthermore, the two period lag is consistent with this finding as these services may take some time to find an applicant a job. As for out-of-work income and support, a positive coefficient is anticipated because payments to the unemployed give these individuals less urgency to find a job which results in higher long-term unemployment. Other ALMP variables were attempted they were not statistically significant.

The impact of ALMPs on very long-term unemployment is investigated using the model shown in Table 4.

Table 4. ALMPs and Very Long-term Unemployment Active Population

Dependent Variable: Very Long-term Unemployment Active Population

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.386173	0.372957	3.716706	0.0138
Job Creation (-2)	-3.376038	1.215863	-2.776659	0.0391
Out-of-work Income Maintenance and Support(-1)	-0.159048	0.039422	-4.034509	0.0100
Inflation	0.311802	0.116025	2.687370	0.0434
R-squared	0.653730			
Adjusted R-squared	0.445967			

Job creation with a two period lag, out-of-work income maintenance and support with a one period lag, and inflation were the only variables found to be statistically significant. Job creation has a negative coefficient indicating that in the very long-term, unemployment will decrease with this public policy initiative. This result is a bit surprising, however, the two period lag suggests that over time jobs are created for those in very long-term unemployment; unlike the previous model which had no lags. Lastly, the model shows that as inflation increases very long-term unemployment also increases. At first glance this result might seem to contradict the Phillips Curve. However, the likely outcome in this case is that those who have been recently unemployed are getting rehired first as their labor skills are still relevant, whereas the long-term unemployed struggle to get work immediately, even in a growing economy.

The last dependent variable examined is the unemployment rate for those less than 25 years of age. As shown in Table 5, there are two independent variables that are statistically significant, population and employment services.

Table 5. ALMPs and Unemployment Under 25 Years of Age

Dependent Variable: Unemployment for those less than 25 Years of Age

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	224.0884	65.64680	3.413547	0.0112
Population	-0.009297	0.003073	-3.025223	0.0192
Employment Services	-6.505929	1.799692	-3.615024	0.0086
R-squared	0.833546			
Adjusted R-squared	0.785987			

As population increases, the unemployment for those less than 25 years of age decreases. This result is not as expected. However, one possible explanation is the age structure in Romania, which is more weighted to the pensioners. As a result, those less than 25 years of age could experience increases in employment. Another possible explanation is that the jobs being created in Romania are low-skilled, low-paying service type jobs that lead to employment of the young.

5. Conclusion

ALMPs are an important public-policy tool utilized by most countries. In particular, ALMPs are used extensively in the European Union, as they are a major component of the Europe 2020 strategy (Van Steendam, et al., 2011). As part of the EU, Romania also integrates ALMPs as part of their economic strategy. While Romania gained EU membership in 2007, the country has used ALMPs since their Revolution in 1989 in an attempt to stabilize what was, and to some extent still is, an unbalanced labor market. The ALMPs were successful in helping the unemployment situation during the transition years after the Revolution. However, since the late 1990s, ALMPs have been considered to be not as successful, arguably because the country was experiencing economic stability. Furthermore, as the economy matured and stabilized, some questioned the government spending much needed money on ALMPs.

This paper has examined the use of ALMPs in Romania during this period of economic maturing, 2003 to 2012. In particular the impact of ALMPs on the unemployment rate, the long-term unemployment rate, the very long-term unemployment rate, and the unemployment rate for those less than 25 years of age were examined. The use of specific ALMPs in Romania were found to have some impact, although as a whole total ALMP spending was found to have no impact. In particular, spending on employment services was found to have a large impact on reducing unemployment while job creation policies actually can contribute to unemployment, at least in the short-run. ALMPs also exhibited mixed results with long-term unemployment. Employment services, after two years, has a large impact on reducing long-term unemployment, while out-of-work income maintenance and support contributes to long-term unemployment even after one year. However, in the cases of very long-term unemployment both job creation, after two years, and out-of-work income maintenance and support, after one year, have a negative impact. As for youth unemployment (under 25), only employment services reduces unemployment. In fact, the variable ‘employment services’, for young people, has a large negative impact on unemployment.

Although this paper examines a relatively small time period, the findings are robust. The findings of this paper can be used to show the Romanian government that funding for ALMPs should be heavily concentrated toward employment services as this ALMP measure is shown to substantially reduce unemployment of all kinds. Moreover, the government could target funds for job creation to those in the very long-term unemployment category. These findings further suggest that spending on other ALMP measures in Romania are not very effective. As a result, the findings presented in this paper are important because the Romanian government could target the limited funds that they have available to these specific ALMPs to have a bigger impact on unemployment reduction and to experience the economic growth that would result. Using analyses similar to the ones presented in this paper can help governments use their limited resources more effectively to provide an economic stimulus and reduce unemployment.

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