Latvian Labor Market before and after EU Accession

Labor market flexibility in Latvia has considerably improved after the EU accession

Mihails Hazans

Between 2002 and 2005, the Latvian labor market witnessed dramatic changes related both to unprecedented economic growth — 28% in three years — and to a massive outflow of the labor force after EU enlargement in May 2004. This emerging shortage of labor has led to strong growth of real wages and reduction of unemployment. Moreover, it has improved the labor market position of ethnic minorities, the elderly, fixed-term workers, the low-skilled, and other disadvantaged groups. Wage growth, in turn, has increased labor force participation, resulting in further increase of employment rates. In fact, employment rate in Latvia has been rising faster than in any other New Member State and faster than in the "old" EU except Spain.

We conduct a detailed analysis of these changes before and after Latvia's EU accession, using micro-level data from Latvian Labor Force surveys for 2002-2005.

Unemployment Risk Much More Even

Unemployment risk has become spread much more evenly across social groups. Unemployment rates have declined in all age groups for men and in most age groups for women; and youth unemployment is no longer considered a serious problem.

Latvia's regions have become less polarized in terms of both unemployment and earnings. While wages in the capital city remain significantly higher than in the rest of the country, and wages in Latgale region significantly lower than in other regions, both gaps have declined since 2002. Similarly, the rural-urban earnings gap has declined considerably in the three year period — in fact, in 2005, average earnings of rural workers were statistically indistinguishable from their peers in urban areas. Plausibly, two factors — improved internal labor mobility and the external mobility shock in connection to the accession — have contributed to these positive developments.

Ethnic Gap Narrowed

While the minority population still has a somewhat lower employment rate, the overall gap reduced from more than six percentage points in 2002 to less than three percentage points in 2005. Moreover, the increase in employment between 2002 and 2005 took place primarily (and as far as women are concerned, exclusively) within minority population. For men, ethnic gaps both in participation and employment disappeared. The ethnic gap in employment rates narrowed in all age groups except the young and the elderly. Nevertheless, for people with tertiary education the ethnic gap in employment remains substantial at ten percentage points, and has not changed significantly since 2002.

Latvians are over-represented in highly skilled non-manual occupations, in non-market services and agriculture, and in the public sector. Non-Latvians are found more frequently in skilled manual and elementary occupations, in industry and market services, and in the private sector. "Vertical" segregation (among nine main groups of occupation) is modest, on average; just 12% of non-Latvians would have to change occupation to make their occupational distribution identical to that of Latvians. This can be largely explained, according to a recent survey of employees in Latvia, by differences in language skills. Among employees with good Latvian language skills just 7% would have to change occupation to make their occupational distribution identical to that of native Latvian speakers, while for workers with medium and poor Latvian language skills 25% and 49%, respectively, would have to change their occupation.

There also exists a wage gap of 9.6% between ethnic groups, which is almost completely unexplained by education, age, occupation or similar characteristics. However, once differences in Latvian language skills are accounted for, the "unexplained" gap in earnings (compared to native Latvian speakers) becomes substantially smaller: 4%, 7%, and 1% for workers with good, medium, and poor knowledge of Latvian language respectively (see Table).

Occupational Segregation and Wage Gaps between Native Latvian Speakers and Other Workers, by Self-Reported Latvian Language Skills Level. Full-time Employees Aged 18-64, 2005, Percent

Knowledge of Latvian Language	Share of Workers	Duncan Index of Occupational Segregation	Gross Wage Differential	Productivity Differential	Unexplained Wage Gap
Native	62.3	-	-	-	-
Good	19.9	7.0	-2.1	-5.7	3.8
Medium	12.2	24.7	10.0	3.0	6.8
Poor	5.4	49.0	13.4	12.4	0.9

Source: Calculations based on data from survey of wage earners for the national program of labor market studies.

Returns to Education Unchanged

What has not changed much in 2005 compared to 2002, are the high returns to tertiary education and low returns to secondary education — by international standards. In 2005, people with higher education earned, on average, 76% more compared to people with basic education, other things being equal; this differential was especially high for females, native Latvians, public sector employees and the rural population. Returns to secondary education remained modest at 10-20%.

As in many post-communist countries (but unlike the Czech Republic for example), returns to experience in Latvia have been decreasing compared to the socialist wage setting system and are at an extraordinarily low level. In a typical industrialized country age-earnings profile in most education groups rises up to the age of 50 (except for female college graduates, for whom the peak is recorded somewhat earlier), after which it decreases. In Latvia, the male earnings profile peaks at the age of 38 for workers with higher education, and at 34 for workers with secondary and basic education. The earnings of a 38-year-old and a 23-year-old only differ by 9% for men and 7% for women — this is a remarkably small difference compared to the US, where the earnings difference between the same age categories amounts to a whopping 100% for men and 70% for women. However, compared to 2002, return to experience has slightly increased for highly skilled male workers.

In sum, the findings of our study suggest that labor market flexibility in Latvia improved considerably after the EU accession. Responding to strong economic growth combined with increased external labor mobility, the Latvian labor market in just three years underwent changes on a scale which is well beyond expectations.

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The Impact of EU Accession on Poland's Economy

Most fears concerning EU entry turned out to be unfounded, except for the increase in prices

Ewa Balcerowicz

Poland's integration into the EU has been a gradual and lengthy process, and it is not yet complete. It is important to note that the developments in the Polish economy in 2004-2006 were influenced to a large extent by institutional and regulatory reforms undertaken in the years prior to the accession.

The transposition of EU legislation allowed Poland to profoundly reform the way in which its economy is regulated and restrict government intervention in the private sector. Changes in such areas as financial markets, company and competition law, accounting, and intellectual property rights have created a better environment for business and have led to economic growth. Poland has also benefited from access to EU structural funds, which can potentially contribute to the improvement of public infrastructure.

Various studies undertaken before the enlargement estimated gains from the enlargement at 1.3-2.1% of additional GDP growth per year. Estimates by CASE showed that trade liberalization and the reduction of technical barriers would bring an increase of 3.4% to Poland's GDP in the long run. The real wages of unskilled workers in Poland were estimated to increase by 1.7%.

Economy Grew 4.2% a Year

In the first two years of EU membership, Poland enjoyed sound economic growth at an average rate of 4.2% a year, and the trend seems to have continued in 2006. At such a rate, Poland ranked eighth among the EU-25 countries, yet lagged behind other new members, such as the Baltic states and Slovakia. Poland's convergence with "old" members is clearly taking place: its GDP per capita (in PPS) increased from 40% of the EU-15 average in 1997 to 46% in 2005, but the pace is too slow and on account of this Poland lags behind most of the New Member States.

GDP, Exports and Imports in 1997–2005, Growth Rates (%)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
GDP	7.1	5.0	4.5	4.2	1.1	1.4	3.8	5.3	3.4
Exports	12.2	14.4	-2,5	23.2	3.1	4.8	14.2	14.0	8.1
Imports	21.4	18.6	1.0	15.5	-5,3	2.7	9.3	15.2	4.9

Source: Poland's Central Statistical Office data

Contrary to pessimistic expectations, export growth rate outpaced that of imports and the foreign trade deficit shrank for a sixth consecutive year. In 2005-2006 the trade balance with the EU countries became positive, implying that the current trade deficit has been generated by trade with non-EU countries. Adoption of the Common Customs Tariffs for trade with third countries led to a drop in average tariffs from 8.9% to 4.1%. Not surprisingly, imports from developing countries (mainly China) rapidly increased. Exports to third countries (mainly to Russia and Ukraine) also reached record levels, helped by export subsidies to trade in foodstuffs that now also apply to Poland. Liberalization of trade in foodstuffs generated an increase of Polish exports to the EU.

FDI Reaches Record High

As forecasted, there was a spectacular increase in FDI inflows in the year of the accession compared to 2003 (see Figure). Altogether EUR 10.29 billion was invested in 2004, nearly reaching the peak level of 2000, when most privatization deals occurred. In 2005 FDI inflows went down by 22%, however forecasts for 2006 are very good. Portfolio investment in Poland also increased.