Chapter 2

Removing demand-side barriers to youth employment in Lithuania

This chapter analyses demand-side barriers to youth hiring in Lithuania, such as the cost of hiring (as determined by non-wage costs and minimum wages), and employment protection legislation. It also discusses policies currently in place to tackle such barriers (including hiring incentives) and offers a range of policy options to create more favourable conditions for employers to hire youth. The key challenges identified in this chapter include: high non-wages costs, particularly on low-wages earners; a flat minimum wage, which does not reflect the productivity of young workers; and overly strict employment protection legislation on both permanent and temporary contracts.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Introduction

Improving labour market outcomes for youth in Lithuania will partly depend upon the creation of a sufficient number of good quality jobs for youth. This will require the support of reform measures aimed at tackling demand-side barriers to youth employment, i.e. labour market barriers that affect the willingness and ability of employers to hire youth. These include policies that have an impact on the cost of hiring and employment protection legislation. High labour costs and/or overly strict employment protection legislation could prevent employers to hire (formally) youth and as a consequence hinder employment opportunities for youth. This chapter analyses demand-side barriers to youth employment, by focussing on the cost of hiring (including both wage and non-wage costs), and on the strictness of the employment protection legislation in Lithuania.

The main findings of the chapter are summarised below:

- ***The cost of hiring***: Employers' social security contributions are very high by OECD standards. They translate into high non-wage costs, ultimately acting as an important factor hindering the willingness of the business sector to hire youth. While existing hiring incentives in Lithuania may mitigate the impact of high labour costs, there is scope for improving their design. Although the minimum wage relative to the average wage is not particularly high, there is scope for considering the move towards a more differentiated wage structure for youth in Lithuania, notably to accommodate the fact that their productivity is generally lower.

- ***Employment protection legislation***: Lithuania has strict employment protection legislation on both permanent and temporary contracts. Strict employment protection legislation may undermine firms' ability to adjust to changing economic circumstances and therefore create a barrier to hiring, especially youth. Introducing more flexibility, while ensuring adequate social protection and assistance to displaced workers, is needed for enhancing employment prospects for youth. There is also a strong case for moving regulation on temporary and permanent contracts more in line with one another in Lithuania.

Addressing these challenges calls for a comprehensive strategy aimed at promoting more and better quality jobs, as well as at improving the distribution of the benefits of growth. Such a strategy should build on recent reforms as underpinned by the reform of the Labour Code, which is currently under elaboration by the Lithuanian Government.

Box 2.1. Key recommendations

There are important demand-side barriers to youth employment in Lithuania, both for what concerns the cost of labour and the strictness of employment protection legislation. As a consequence, the OECD suggests that:

- The cost of hiring young workers should be contained. In particular:
  - Reductions in employers' social security contributions should be introduced to complement existing hiring incentives. At the same time, foregone social security contributions should be shifted towards other forms of taxation (such as wealth and environmental taxation) to achieve revenue neutrality.
  - Existing hiring incentives should be re-designed in a way to minimise substitution effects, by imposing more effective conditions on employers. These may include obligations to reward only net employment gains in the company; provide training to subsidised workers; hire the worker beyond the subsidy period. There is also scope for improving the targeting of some programmes, such as the "Support for the First Job".
  - More robust and regular evaluation of hiring incentives should be conducted, not only on the effect of subsidies on participants, but also on the size of deadweight and substitution effects.
  - In addition, the Lithuanian Government could consider introducing a more differentiated structure of wages for youth. International experience suggests that two options are available to Lithuania, i.e., the introduction of sub-minima wages for youth, or training wages. Under the first option, in order to mitigate the impact of sub-minimum wages on youth's net incomes, the non-taxable income could be increased to the level of (sub-) minimum wages.
- Employers should be given more flexibility to adjust quickly to changing economic circumstances. In particular:
  - Employment protection legislation should be relaxed on permanent contracts. In particular, dismissal notice periods should be shortened and severance pay reduced at least for people with shorter job tenure.
  - Smaller firms in Lithuania should be regulated by more flexible employment protection legislation. The Labour Code should ease dismissal procedures for smaller firms, notably by shortening notice periods and reducing severance pay. However, a careful balancing is needed when exempting small firms from employment protection requirements, as too generous exemptions may impede firm growth.
  - Longer trial periods should be introduced in Lithuania. This would allow employers more time to test new workers and reduce the risk associated with taking on new unexperienced workers, such as youth.
  - Temporary contracts should be liberalised to a certain extent. However, liberalisation of temporary contracts should be carefully balanced so as to avoid the creation of a dual labour market characterised by too different regulations between fixed and permanent contracts.

Promoting labour cost policies that do not hamper employment prospects for Lithuanian youth

High labour costs can be a barrier to (formal) employment, especially for the low-skilled and those who lack work experience, including youth. They can result from high statutory minimum wages relative to average or median wages, and/or from high non-wage costs, such as employers' social security contributions and payroll taxes. Non-wage costs to employers (i.e., employers' social security contributions) are comparatively high in Lithuania, especially for low-wage and minimum wage earners, even though several hiring incentives are used to reduce the cost of hiring youth. At the same time, while the minimum relative to the median wage is only marginally higher than what is observed across OECD countries on average, it may still be above the expected productivity of young workers. In Lithuania, the combination of high non-wage costs and relatively high minimum wages may translate into disincentives for employers to hire formally the low-skilled and those with less work experience, such as youth.

Addressing high non-wage costs and the tax wedge should be a priority

This section discusses the impact of the tax wedge – i.e. the sum of personal income taxes, employee and employer social security contributions plus any payroll tax less cash transfers, expressed as a percentage of labour costs[1] – on employers' hiring behaviours, in the context of the comparison between Lithuania and the OECD countries. A detailed discussion of the different components of the tax wedge in Lithuania is provided in Box 2.2.

In Lithuania, employers' SSCs equal 30.8% of gross wages,[2] while employees' SSCs equal 9% of gross wages (Ministry of Social Security and Labour, 2014; OECD, 2015a). Personal income taxes are fixed at a flat rate of 15%, although some progressivity is allowed by the basic tax-exempt amount (BTEA). Figure 2.1 compares the decomposition of the tax wedge in Lithuania with the OECD average at different levels of income, notably low-income earners (those at 67% of average earnings), average-income earners (at 100% of average earnings), and high-income earners (at 167% of average earnings). The tax wedge is higher in Lithuania than across the OECD for all income groups, a situation that mainly reflects significantly higher employers' social security contributions (27.3% of labour cost at average earnings versus an OECD average of 14.3%). The World Bank's Doing Business data also come to similar conclusions: at 35.2% of company profits, labour tax and contributions in Lithuania are significantly higher than those typically observed in OECD countries (23%). Furthermore, a singularity of the Lithuanian tax wedge is that it is largely income invariant. This is mainly due to flat personal income taxes, with only a small progressivity effect allowed by a progressive BTEA.

Box 2.2. Social security contributions and personal income taxes in Lithuania

Personal income taxes

Personal income taxes in Lithuania are a flat rate of 15%. Some progressivity is allowed by the basic tax-exempt amount (BTEA) – i.e. non-taxable income – which is highest at low-income levels. BTEA is equal to EUR 166 per month for individuals earning less than EUR 290 per month; it decreases progressively for individuals earning between EUR 290 and 939 per month[1] while there is no basic tax exempt amount for people earning more than EUR 939 per month (OECD, 2015a). Additional BTEA is granted to parents raising children up to 18 years of age or older if they are attending secondary education. BTEA is updated on a regular basis and was last increased in January 2015.

Social security contributions

Social security contributions are managed by the State Social Insurance Fund Board of the Republic of Lithuania under the Ministry of Social Security and Labor (SODRA). Table 2.1 provides information on the different components of employers and employees' social security contributions.

Table 2.1. Social security contributions in Lithuania, 2015

Percentage of the gross wage

	Pension	Sickness and maternity	Unemployment	Health	Total
Employers	23.30%	3.40%	1.10%	3%	30.80%
Employee	3%	–	–	6%	9%

Source: Ministry of Social Security and Labour (2014), *Social Insurance Contributions*, [online], available: http://www.socmin.lt/en/social-insurance-1975/social-insurance-contributions.html, accessed 16 April 2015.

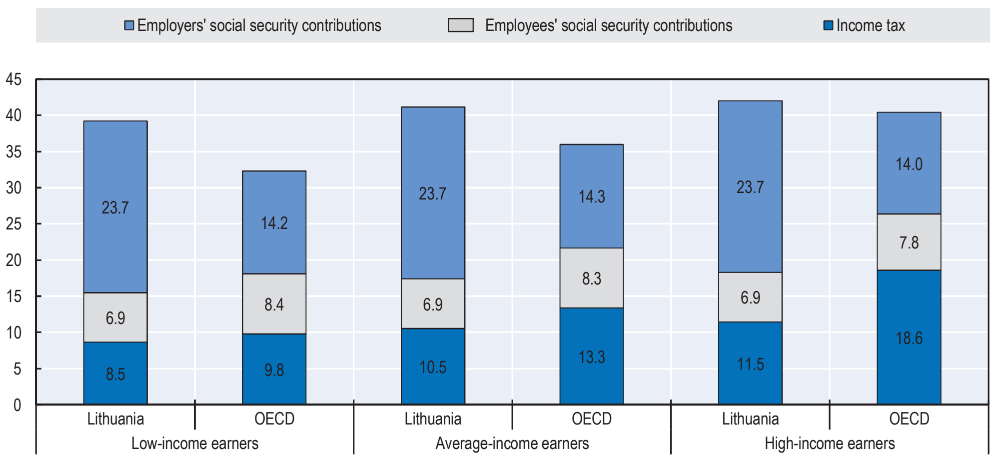
1. For this income bracket, the BTEA equals to 166 – 0.26*(gross monthly earnings – 290) (PwC, 2015).

Source: Ministry of Social Security and Labour (2014), *Social Insurance Contributions* [online], available: http://www.socmin.lt/en/social-insurance-1975/social-insurance-contributions.html, accessed 16 April 2015; OECD (2015), "Benefits and Wages: Lithuania", Country chapter, http://www.oecd.org/els/social/workincentives, accessed 3 April 2015.

This evidence points to the fact that non-wage costs might exert a strong impediment to (formal) employment in Lithuania, especially the hiring of low-skilled workers and youth, who are likely to earn below-average wages. This is consistent with previous evidence, which identifies high tax wedges, especially on low-income earners, as one of the main causes of structural unemployment in Lithuania (European Commission, 2015; IMF, 2014; 2007; Ebeke and Everaert, 2014; World Bank, 2005). A similar point is made by the Enterprise Surveys of the World Bank and IFC (2013), which concludes that tax rates are perceived by Lithuanian firms as the single most important barrier to the expansion of the business sector, especially small- and medium-size enterprises.

Figure 2.1. The decomposition of the tax wedge, Lithuania and OECD average, 2014

Percentage of labour costs



Note:

The tax wedge refers to single individual without children.

Labour costs are defined as the sum of gross earnings, employer social security contributions and payroll taxes, where applicable.

Low-income refers to 67% of the average wages; average-income refers to 100% of average wages; high-income refers to 167% of average wages.

In Lithuania, income taxes, employer and employee SSCs are estimated based on gross average wages of EUR 714.5 per month in Q4 2014.

Source: For Lithuania, OECD calculations based on OECD (2015), "Benefits and Wages: Lithuania", Country chapter, http://www.oecd.org/els/social/workincentives, accessed 3 April 2015; for OECD countries, *OECD Public Sector, Taxation, and Market Regulation Database*, http://stats.oecd.org/.

The OECD countries have put in place specific mechanisms to address high non-wage costs to employers hiring youth, such as reductions in employers' social security contributions targeted to youth (see Box 2.3). Reductions in social security contributions for all or most low-wage earners have been introduced recently, or expanded, in Belgium, France, Italy, the Netherlands and the United Kingdom, for example, with the aim to spur job creation for the low skilled (see also OECD, 2015b, for further details). While, of course, these measures do not aim to target any specific groups, they are likely to primarily benefit youth people, whose entry wages are generally lower. In Lithuania, the reduction of the tax wedge for youth or low-income earners could be accompanied by a shift of the tax burden to other sources less detrimental to growth and employment – such as environmental and wealth taxation. This is also a recommendation of the European Commission Council in 2015 (European Commission, 2015b).

Box 2.3. Reductions in employers' social security contributions targeted to youth

Reductions in employers' social security contributions are a common strategy adopted by some OECD countries to reduce non-wage costs and encourage firms to hire at-risk population groups, such as youth. These programmes are generally adopted in countries where non-wage costs tend to be high and can have negative employment effects on some disadvantaged population groups.

As a mean to tackle the current economic crisis and improve labour market prospects for youth, some OECD countries, such as Greece, Poland, Slovenia, Sweden and Turkey for example, have recently introduced temporary measures to reduce employers' social security contributions for companies hiring young people.

In Greece the "Acquisition of Work Experience for New Entrants in the Labour Market" programme provides subsidies to enterprises hiring unemployed youth (ages 16-24) equaling 70–80 % of social security contributions (capped to minimum wage levels), with the possibility to expand the subsidy for a further 12 months if the work experience programme is transformed into a work contract (European Commission, 2014b).

Poland is introducing a range of new measures targeted at unemployed young people (aged under 30). These include reductions in social security contributions for six months for employers hiring young people, under condition that the employer retains the young person in employment for a minimum of six months after the subsidy period ends (OECD Questionnaire "Recent Policy Measures and Reforms to Improve Labour Market Outcomes for Youth", 2014).

In Slovenia, the "Emergency Measures in the Field of Labour Market and Parental Care Act" introduced a temporary measure by means of which an employer who hires on a permanent contract a young person (ages 30 or below) registered as unemployed for at least three months is exempted from paying employer's social security contributions for the first 24 months of employment (OECD Questionnaire "Recent Policy Measures and Reforms to Improve Labour Market Outcomes for Youth", 2014).

In Sweden the government has lowered employers' social security contributions for young people under the age of 26 from 31.42% to 15.49%. With the aim to facilitate a more rapid school-to-work transition, the government proposed a further reduction in the employers' SSCs rate to 10.21% for people under the age of 23, while reduced employers' SSCs are maintained at 15.49% for young people aged 23-25 (Swedish Ministry of Employment, 2014).

Box 2.3. Reductions in employers' social security contributions targeted to youth *(cont.)*

In Turkey, the employers' social security contributions for youth (aged 18-29) recruited between May 2008 and May 2010 has been covered for a period of five years by the Unemployment Insurance Fund (UIF). Starting at 100% the first year, the subsidy gradually decreases to 20% in the fifth. In order to benefit from the programme, the employer must have hired youth who were registered as unemployed for at least six months (OECD, 2011). In order to minimise substitution effects, the subsidy is provided as long as the additional worker represented an increase in the enterprise's workforce.

Source: Swedish Ministry of Employment (2014), "Youth Employment Policies in Sweden – The Swedish Response to the Council Recommendation on Establishing a Youth Guarantee"; OECD and ILO (2011), "G20 Country Policy Briefs: Turkey. Supporting Employment Through Reduced Social Security Contributions", on occasion of the Meeting of Labour and Employment Ministers, 26-27 September 2011, Paris.

Hiring incentives need to be made more effective

Hiring incentives are used in many OECD countries to reduce the cost of hiring and encourage firms to take on disadvantaged population groups. The international experience suggests that hiring incentives may be particularly useful to support the employability of youth people, since employers may be reluctant to hire young unexperienced workers if labour costs are set at a level above their expected productivity levels (OECD, 2015b). A period of subsidised employment can provide firms the opportunity to observe the motivations and competences of young workers and increase their productivity (both through work experience and on-the-job training) until it is commensurate with the unsubsidised wage paid. By reducing the cost of labour, hiring incentives can also encourage employers to declare their newly hired youth and therefore can help reducing informal employment. At the same time, it is important to ensure that hiring incentives are designed in a way that minimises the risk of deadweight losses (i.e. subsidising jobs that would have been created even in the absence of the subsidy) and substitution effects (i.e. crowding out non-subsidised workers to the advantage of subsidised workers).

Although hiring incentives in Lithuania play a role in improving employment prospects of targeted youth…

Different types of hiring incentives programmes are available to employers in Lithuania: these include wage subsidies for new hiring ["Support for the First Job" (*Parama pirmajam darbui*) and "Subsidised Employment" (*Įdarbinimas subsidijuojant*), "Job Rotation" (*Darbo rotacija*)], Public works[3] (*Viešieji darbai*), and up-skilling hiring subsidies ["Support for the Acquisition of Professional Skills" (*Darbo įgūdžių įgijimo rėmimas*)] (see Box 2.4). While most programmes are directly implemented by the Lithuanian Labour Exchange (the Lithuanian public employment service), some are provided and financed by other local bodies. For example public works are provided and financed by the municipalities jointly with the Lithuanian Labour Exchange. Other programmes, such as "Support for the First Job", are funded by the European Social Fund and are administered by an independent entity, the *Investicijų ir verslo garantijos* UAB (INVEGA). Some of these programmes have been recently scaled up following the implementation of the European Youth Guarantee (see Chapter 3 for a discussion of the implementation of the European Youth Guarantee in Lithuania).

A number of works are available to evaluate the effectiveness of hiring incentives in Lithuania (PPMI, 2015; Bartasevičius, n.d.; European Commission, 2014a). Thanks to these works it is possible to draw some conclusions about the impact of existing hiring incentives on the employment outcomes of participants. Broadly speaking, hiring incentives appear to have a positive impact on employment rates of participants, with the notable exception of public works which have a smaller and in some cases negative impact (see Chapter 3 for further a discussion of public works).

Box 2.4. Hiring incentives tackling Lithuanian youth

Support for the First Job

The measure "Support for the First Job" (*Investicijų ir verslo garantijos*, LTD), financed by the European Social Fund (ESF), was introduced in Lithuania in 2012 to promote youth employment. According to the measure, employers hiring youth (aged 16-29) with no previous work experience can receive a wage subsidy equal to 23.3% of the gross salary paid to the employee. Compensations are paid on a maximum wage of EUR 492.30 per month, and as a consequence the value of the compensation can in no case exceed EUR 114.70 per month.[1] The wage subsidy is paid for a maximum of 12 months (see, for more details, the webpage of *Investicijų ir verslo garantijos* UAB, INVEGA, the independent agency in charge with administering the programme). The overall budget for this measures is EUR 9 270 000, and it is estimated that around 20 000 youth in total will benefit from this measure (European Social Fund, 2014). Although the project is going to end in September 2015, a similar project funded by the European Union will be introduced and shall be operational until 2020.

Box 2.4. Hiring incentives tackling Lithuanian youth *(cont.)*

Subsidised employment

The measure "subsidised employment" is regulated by Article 24 of the Law on Support for Employment. Under this measure, employers hiring youth (ages 16-29) who are registered in the Lithuanian Labour Exchange can have 50% of the gross wage reimbursed for a period not exceeding six months. Priority is given to long-term unemployed youth, young parents of two children, and youth originating from families that have two or more family members registered in the Lithuanian Labour Exchange. The compensation equals 50% of the wage and cannot exceed two minimum wages per month (EUR 600 monthly or EUR 3.64 hourly). Employers who fire subsidised workers (within six months after the subsidy period) cannot receive subsidised employment for at least 12 months. In 2014, over 9 700 youth were hired under "subsidised employment" in Lithuania.

Job rotation

Job rotation programme is organised in cases when unemployed people are hired to temporary replace employees that are on leave (e.g. parental leave, educational and sabbatical leave). PES provides employer with a wage subsidy of up to 0.5 of the minimum wage for a maximum of 12 months. The programme attracts relatively few participants – 400 people in 2012, which suggests even fewer youth participated in the programme.

Support for the acquisition of professional skills

The measure "support for the acquisition of professional skills" is also regulated by Article 24 of the Law on Support for Employment. The measure provides partial wage subsidies to employers hiring youth (ages 16-29) who need to acquire new skills. These include: those who have been given a notice of dismissal; long-term unemployed; and those who start a job for the first time. The compensation equals 50% of the wage and cannot exceed two minimum wages per month (EUR 600 monthly or EUR 3.64 hourly). The duration of the subsidy is five months, while it is 12 months for youth starting a job with a newly acquired qualification. During 2014, over 2 000 youth participated in this programme.

Public works

Public works are provided and financed by the Lithuanian Labour Exchange and municipalities. The total duration of public works carried out by a job seeker can in no case exceed six months over a period of 12 months. An employer who hires a job seeker sent by the Lithuanian Labour Exchange to carry out public works is entitled to receive a wage subsidy for the hours worked by the employed person equalling the minimum hourly wage plus a compensation for social security contributions (Nekrošius and Petrylaitė, 2010).

1. Corresponding to LTL 1 700 and LTL 396.10 respectively.

Source: INVEGA (n.d.), *Support for the First Job* [online], http://www.invega.lt/en/services/support-for-the-first-job-invega.htm, accessed 31 March 2015; European Social Fund (2014), *Projects* [online], available: http://ec.europa.eu/esf/main.jsp?catId=46&langId=en&keywords=&theme=0&country=387&list=1, accessed 17 April 2015.

…their design can be improved

At the same time, other relevant dimensions need to be taken into account to assess the effectiveness of hiring incentives. The first is deadweight losses, i.e. it is important to ensure that the subsidies are not spent for jobs that would have been created even in the absence of the subsidy. The second is the need to control for possible substitution effects, i.e. the risk that hiring incentives crowd out non-subsidised workers to the advantage of subsidised workers. While neither of these difficulties is fully avoidable, effective hiring incentives should be managed in such a way to minimise these adverse effects. Effective targeting of the individuals who need most help in finding work, and the imposition of enforceable requirement conditions to employers can be particularly important to this end.

There are reasons to believe that risks of deadweight losses do not represent a major source for concerns in Lithuania, so long as the hiring subsidies that are directly administered by the Lithuanian PES are concerned. Indeed, these programmes are designed with a view to target, as a priority, registered unemployed youth who are most in need, notably the long-term unemployed and the low-skilled. On the other hand, the case for taking a closer look at deadweight losses may be important when it comes to the programme "Support for the First Job", which is not under the direct administration of the Lithuanian Labour Exchange and targets a broadly defined youth group with no previous work experience. Such a rather large group includes people facing different obstacles in entering the labour market. However, impact evaluation studies that are available in Lithuania have so far neglected to measure the existence and magnitude of such deadweight losses (see Box 2.5 for examples of evaluation studies across the OECD).

More could also be done in Lithuania to make sure that hiring subsidies do not generate substitution effects. Existing hiring subsidies in Lithuania typically impose lose conditions to employers, reflecting the fact that they simply define the generosity and length of the subsidy. One notable exception is "Subsidised Employment", which imposes some penalties to employers who dismiss subsidised workers (see Box 2.4 for further details). As a consequence of weak obligations imposed, there is a risk that employers in Lithuania substitute unsubsidised with subsidised workers, without engaging in long-term working relationships with their employees. As a result, youth may be used as a source of temporary subsidised labour. Again, impact evaluations in Lithuania have not assessed the existence and size of substitution effects, mainly due to data limitations (see Box 2.5).

The international experience suggests that substitution effects can be significantly reduced by imposing more effective conditions on employers (European Commission, 2014a; 2014b):

- One option implemented by many OECD countries is to provide hiring incentives only for additional positions. Turkey, for example, gives a hiring incentive, in the form of reduced social security contributions, to employers who hire unemployed youth who represent an increase in the enterprise's workforce (see Box 2.3). Similarly, Italy has recently introduced wage subsidies for firms hiring long-term unemployed and/or low-skilled youth (ages 18-29) provided that the new hiring represent an increase in the number of employees in the firm (Italian Ministry of Employment and Social Policies, 2015).
- As another option, access to hiring incentives could be made contingent upon the provision of some form of training. One example is the "Jobs for the Future" (*Emploi d'Avenir*) programme implemented in France, which requires employers to provide substantial training and counselling to subsidised young workers (French Ministry of Labour, 2015).
- Furthermore, some countries require employers to hire workers beyond the subsidy period. For example, Poland is introducing new subsidies to hiring youth, under condition that the employer retains the young person in employment for a minimum of six months after the subsidy expires (see Box 2.3). As another example, in Austria the "Come Back" employment integration subsidy provides "checks" to stop misuse, e.g. if none of the subsidised workers are hired after the subsidy period, this is considered to be misuse (European Commission, 2014a)[4].

One lesson from international practices for designing hiring incentives is that there is a balance to be found between conditions imposed on employers, on the one hand, and the perceived burden and attractiveness of the hiring incentive, on the other. A balanced approach is important to ultimately encourage actual take-ups (European Commission, 2014a; 2014b).

Box 2.5. Evaluating deadweight and substitution effects of hiring incentives across the OECD

Several different approaches are available to measure deadweight and substitution effects of hiring subsidies. Some works use questionnaires administered to firms where firms are asked if the subsidised jobs would exist even in the absence of the subsidy (deadweight), and/or if the firm would hire the same worker even in the absence of the subsidy (substitution). Although this approach allows a quick assessment of the possible deadweight and/or substitution effect, underreporting by employers may result in underestimation of the effect. An example of this type of evaluation was carried out in the Netherlands by Welters and Muysken (2006). Another common approach to measure deadweight effect is to use variation in eligibility to participate in the programme. The effects in this case are measured using difference-in-difference, regression discontinuity analysis or panel regressions. In Germany for example, Boockmann et al. (2012) evaluates the size of deadweight effect of hiring incentive for older workers (age above 50). To estimate deadweight effects the authors compare the number of estimated additional hirings to the number of subsidies distributed.

Available works also use firm level data to measure substitution effects by modelling employment levels of firms in the absence of the subsidy. The effect in this case is measured as a change in firm's total employment after receiving the subsidy. Such type of evaluation was conducted in Finland by Kangasharju (2007). Finally, some papers aiming to evaluate substitution effects of subsidised employment programmes use data at the regional level. In Sweden, for example, Dahlberg and Forslund (2005) explain changes in municipality employment level by changes in programme intensity.

Source: Welters, R. and J. Muysken (2006), "Employer Search and Employment Subsidies", *Applied Economics,* Vol. 38, No. 12, pp. 1435-1448; Boockmann B., T. Zwick, A. Ammermüller and M. Maier (2012), "Do Hiring Subsidies Reduce Unemployment Among Older Workers? Evidence from Two Natural Experiments", *Journal of the European Economic Association,* Vol. 10, No. 4, pp. 735-764; Kangasharju, A. (2007), "Do Wage Subsidies Increase Employment in Subsidized Forms?", *Economica*, pp. 51–67; Dahlberg, M. and A. Forslund (2005), "Direct Displacement Effects of Labour Market Programmes", *Scandinavian Journal of Economics*, Vol. 107, pp. 475-494.

Options for a youth minimum wage in Lithuania

Minimum wages can help ensure that fair wages are paid to workers, while at the same time increasing incentives to work especially for certain population groups, such as the low skilled and young people (OECD, 2014; 2010). However, the level of minimum wages must be set at an appropriate level. Too low a minimum wage may fail to address in-work poverty, thus leading to undesirable low wages (when not undermine work incentives altogether) for large numbers of workers, especially those without representation in the wage-setting process and others in a particularly weak bargaining position. Too high a level, especially if combined with high non-wage labour costs, may leave little room for rewarding employees in line with productivity, thus leading to job losses, informal work or reduced working hours for the most disadvantaged groups, including the youth. Evidence analysis shows that job losses are more likely when minimum wage are high to start with, and when labour markets are already weak, e.g., after economic downturns (Broecke, Forti and Vandeweyer, forthcoming; OECD, 2015b). Instead, moderate minimum wage increases typically do not result in job losses overall and there is some evidence that they may contribute to support workers' productivity.

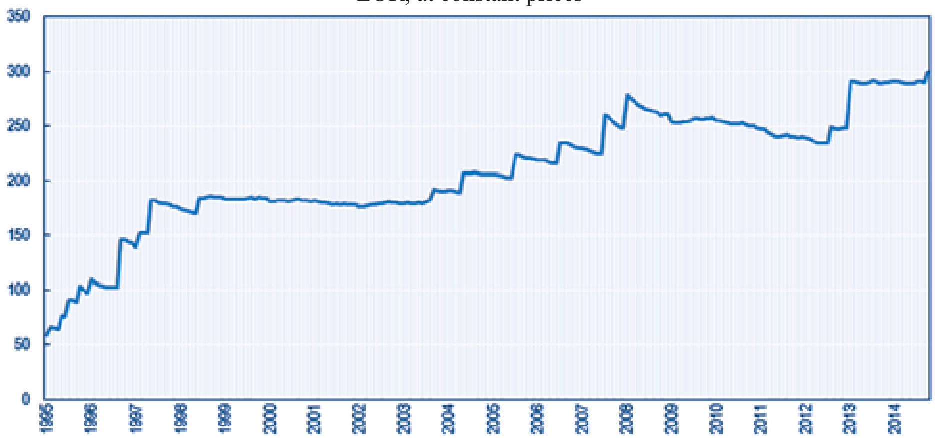
Lithuania has a statutory minimum wage since 1995. According to the Labour Code (Article 187), the government, upon the recommendation of the independent *Tripartite Council*, determines the level of the minimum wage. In its assessment the *Tripartite Council* accounts for the criteria set forth by the ILO Recommendations No. 135:1, such as the general level of wages in the country, the cost of living, as well as labour market conditions (Wageindicator, 2015). Throughout its history, the minimum wage has been subject to a series of freezes (such as during the global and financial crisis) and ad-hoc increases. The minimum wage is calculated on an hourly and monthly basis (40 working hours per week) (Labour Code, Article 144), with the current level being set at EUR 1.82 per hour, or EUR 300 per month. The legislation allows setting different minimum wages through the existence of sectors, categories, or regional wage agreements (Labour Code, Art. 187). However, in practice there is a single national minimum wage in Lithuania and no sub-minimum wages exist for youth (Wageindicator, 2015).

Analysis of the EU-SILC data (2010) suggests that in Lithuania around 18.4% of workers are paid at the hourly minimum wage or below. This is generally much higher than what is observed across OECD countries – where around 5% of the workforce is paid at the minimum wage or below (OECD, 2010) – and Baltic countries – where the figure is around 5% in Estonia and 15% in Latvia (OECD, 2015b). On the other hand, unlike most OECD countries youth are not overrepresented among minimum wage-earners in Lithuania. This feature is common among Baltic countries, more generally. Indeed, in Lithuania 19.3% of young people (ages 15-29) earn minimum wages or below, compared to 18.2% of Lithuanian adult workers (ages 30-64). This small gap points to the fact that earning potential remains low well beyond the early stages of people's careers, or that some of them may receive additional compensation on top of formal earnings (e.g. in the form of "envelope payments") (Chapter 1; see also OECD, 2015b for a comparative discussion).

The real value of the minimum wage in Lithuania today is over four times higher than what it was 20 years ago when it was introduced (Figure 2.2): it moved from EUR 58 per month in 1995 to EUR 300 in 2014. The real value of the minimum wage recorded sharp increases during the period from 1995 till mid-1997; it remained stable from mid-1997 until the end of 2003, and then peaked again until the beginning of the crisis (Q3 2007). From the crisis to the second half of 2012, workers experienced a five-year decline in the real minimum wage, reflecting no increases in its nominal value. After the second half of 2012 the value of minimum wage was increased again in October 2014 (up to the current monthly level of EUR 300).

Figure 2.2. Monthly minimum wage, Lithuania, 1995-2014

EUR, at constant prices[a]

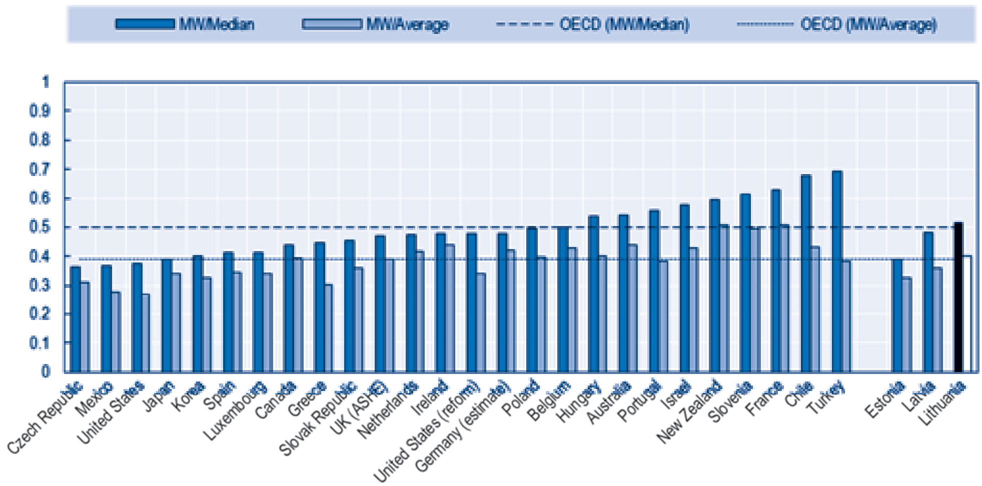


a) The deflator used is the consumer price index (CPI) (October 2014 prices).

Source: OECD calculations based on Statistics Lithuania and the *OECD Earnings Database*, http://stats.oecd.org/.

International perspective shows that in Lithuania the level of the gross minimum wage, expressed as a percentage of both the average and the median wages, is at present only marginally above the level observed for the average of the OECD countries which have a statutory minimum wage (Figure 2.3). Comparing Lithuania with the other Baltic countries shows that the minimum wage is higher in Lithuania: 52% of the median wage, as against 48% in Latvia and 39% in Estonia. It should be acknowledged, however, that the ratio for Lithuania has been driven by a low median wage (which has declined strongly during the crisis) rather than an increasing minimum wage. This points to the fact that further increases in the minimum wage would not hurt jobs opportunities if indexed on the median wage – as this latter could increase again as economic growth picks-up. At the same time, many OECD countries have introduced sub-minimum wages for youth (see discussion below) – which suggests that minimum wages for *youth* in Lithuania could be higher than in other countries.

Figure 2.3. Minimum wage (MW) relative to average and median wage of full-time workers, Lithuania, OECD and Baltic countries, 2013



Source: OECD (2015), *OECD Employment Outlook 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2015-en.

Moving from the current uniform minimum wage structure to a more differentiated wage structure for youth could be an option worth considering in this context. By easing access to the labour market of the least skilled, it would reduce their likelihood of falling into long-term unemployment or becoming NEETs. Furthermore, introducing sub-minimum wages may encourage formal hiring. Indeed, informal employment is pervasive in Lithuania, especially across youth (see Chapter 1), suggesting that the current uniform structure of minimum wages may not be optimal, with potentially adverse employment effects on Lithuanian youth.

There is no-one fits all approach to address these issues. This report proposes two alternatives:

- The first more ambitious option would involve a move towards a reduced minimum wage level for younger workers, similar to the approach now in use by about half of the OECD countries (Table 2.2). The economic and employment rationale behind this approach is that a lower but well enforced minimum for youth can help maintain minimum pay standards, while compensating for specific barriers that young people face when entering the labour market. In some of the countries where sub-minimum wages for youth exist – notably Australia, Belgium, France, Israel, Luxembourg, the Netherlands, the Slovak Republic and the United Kingdom – they increase progressively with age. Increasing minimum wages in several small steps avoids large jumps in labour costs from one year to the next, and helps to lower the risk that employers would base hiring and firing decisions primarily on age or seniority.

- If the Lithuania authorities believe that the prospect of a lower minimum wage for youth is not applicable to the country, *training wages* for youth people on apprenticeships provides an alternative option to that of sub-minimum wages. While lower, because of the need to account for the productivity differential, *training wages* could be designed in such a way to progressively increase, as learning advances. Some OECD countries already apply this form of lower wages for workers under training – such as people on apprenticeships. France, for example, uses minima that vary by age, seniority and employment contracts and applies specific lower rates (ranging between 55 and 85% of the standard rate) to youth on a training contract, workers on vocational training (any age, between 25 and 78% of the standard rate) and to youth under 18 years old and less than six months of employment (80-90%) (OECD, 2015b).Should this option be preferred, it will need to be implemented together with adequate provisions to ensure a high quality of the training provided. This is needed to prevent the risk that employers benefit from cheap labour without providing any qualitative training to young workers.

Table 2.2. Sub-minimum wages for young people in OECD and Baltic countries

Country	Exemptions/variations	
	Youth (% of minimum wages)	Others
	OECD countries	
Australia	15: 36% 16: 47% 17: 57% 18: 68% 19: 82% 20: 97%	There are currently three categories of minimum wage: 1) modern award minimum wages, which are occupation- and industry-specific; 2) the national minimum wage, which is used as a "safety net" and is of general application to all industries and occupations; 3) special national minimum wages, which apply to specified categories of vulnerable workers, like junior employees, trainees and employees with a disability.
Belgium	n.a.	n.a.
Canada	n.a.	Varies by region (province and territory), by industry in certain provinces (e.g. Ontario, Québec) and by occupation (e.g. some occupations for which workers receive tips, like bartenders and waitresses).
Chile	15-17: 74%	Varies by age. Lower rates for older workers (>65): 75%.
Czech Republic	n.a.	Varies by disability. Lower rates for people with disabilities (employees receiving invalidity pensions).
France	<17: 80% 17-18: 90% + lower rates for young people employed in a training contract (Contrat de professionnalisation)	Lower rates for childcare assistants (*assistants maternels*), certain carers (*assistants familiaux*), apprentices and disabled workers.
Germany	<18: no minimum wage	Exemptions for some branches allowed until 2017. Long-term unemployed exempted during the first six months of employment.
Greece	<25: 89%	Varies by occupation (higher rates for white collar workers).
Hungary	n.a.	There are two types of minimum wage in Hungary – the Guaranteed Minimum Wage (for professional workers in professional occupations) and the National Level Minimum Wage.
Ireland	<18: 70%	n.a.
Israel	16: 70% 17: 75% 18: 83%	n.a.
Japan	n.a.	There are two different categories of minimum wages: 1) regional minimum wages, which are to be decided across the board for each region nationwide; and 2) special
Korea	n.a.	Lower rate for apprentices who have been in the apprenticeship for less than three months: 90%.
Luxembourg	15-16: 75% 17: 80%	Varies by skill level (20% higher for those with a professional qualification).
Mexico	n.a.	Varies by region and occupation. There are three different general minimum wages (that vary by region) and 86 different occupational minimum wages fixed by the National Commission on Minimum Wages.
Netherlands	15: 30% 16: 34% 17: 39% 18: 45% 19: 52% 20: 61% 21: 72% 22: 85%	May vary by sector/firm. The government may decide to decrease the minimum wage for a certain enterprise or sector, in cases of severe adverse economic development
New Zealand	<20: 80% For some workers with less than six months job tenure	Varies by contract type (apprentices) and disability.

Table 2.2. Sub-minimum wages for young people in OECD and Baltic countries *(cont.)*

Country	Exemptions/variations	
	Youth (% of minimum wages)	Others
	OECD countries	
Poland	n.a.	n.a.
Portugal	<18: 75%	Varies by region and contract type. Higher minimum wages for the Autonomous Region of Açores and for the Autonomous Region of Madeira. Lower rates (up to - 20%) for apprentices and interns, as well as disabled employees for a period that cannot exceed one year.
Slovak Republic	<18: 80% 18-21: 90%	The legislation determines one statutory level of the minimum wage, which is multiplied by coefficients depending on the difficulty of position. Lower rates are applied for employees receiving a disability pension.
Slovenia	n.a.	n.a.
Spain	n.a.	n.a.
Turkey	n.a.	n.a.
United Kingdom	15-17: 59% 18-20: 80%	Varies by training contract. Lower rates for employees in recognised apprenticeship schemes.
United States	<20: 58% during their first 90 consecutive calendar days of employment with an employer.	Varies by region, disability, as well as student status. Most states have either the same or a higher rate than the federal rate. Five states have no MW and two states have a lower MW and workers are entitled to the federal rate). Partial exemptions for workers with disabilities, full-time students, and student-learners employed pursuant to subminimum wage certificates.
	Baltic countries	
Estonia	n.a.	n.a.
Latvia	Higher hourly rates for <18 (114%	Special hourly rates for youth and for those working under risky or dangerous circumstances who are allowed to work only 35 hours per week to reach the same weekly rate as normal workers
Lithuania	n.a.	Although the legislation specifies that specific wage rates may be set for different regions, sectors and categories of employees, only a uniform statutory minimum wage or national minimum wage is currently valid all over the country.

Source: OECD (2015), *OECD Employment Outlook 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2015-en.

Many observers in Lithuania are concerned that the more ambitious approach of a lower minimum wage for youth could trigger an increase in the incidence of low-pay jobs among youth, whose wages are already relatively low. One policy option to mitigate this concern could be to combine the introduction of the lower minimum wage for youth with a new provision to increase the statutory level of the monthly non-taxable income (basic tax-exempt amount, BTEA[5]), which is currently set at EUR 166 per month (see Box 2.2). Coupled with the increase of the non-taxable income, the introduction of the sub-minimum wages for youth could provide for more decent living conditions for the youth, while at the same time strengthening the employers' incentives to hire youth workers through the formal channel. By increasing net take-home pay of individuals at bottom income levels, it would also allow for some redistributive effects and reduce income inequalities. The impact of this measure on overall tax revenues could be offset by increasing other forms of taxation such as wealth and environmental taxation (see also European Commission, 2015b).

From the governance perspective, under either option the *Tripartite Council* – which consists of government, trade unions and employer organisation and is already well placed to consider a wide range of economic and social factors – would be in an ideal position to establish the necessary links between the general minimum wage policy and the lower minimum wage, or *training wages*, for youth. Public consultations and a requirement to publish recommendations promote minimum-wage adjustments that are transparent and predictable for both businesses and workers, including the youth.

Delivering a less strict employment protection legislation to strengthen youth hiring

Employment protection legislation (hereafter EPL) – the set of rules established either by law or collective bargaining applicable to the hiring and firing of permanent workers and to the use of temporary work contracts – aims to protect workers and increase job stability. However, if too rigid it can undermine firms' ability to adjust to changing economic circumstances and therefore create a barrier to hiring. And as new entrants in the labour market, youth would, more likely than adults, be affected by the consequences of strict EPL (OECD, 2004; 2010; Scarpetta, 2014; Muravyev, 2014). Indeed, although age is generally not mentioned explicitly in EPL, some factors such as not having a dependent family or having less seniority at the company, may translate into less job protection and fewer hiring opportunities for young workers (OECD 2004; 2010).

In Lithuania, regulation on hiring and firing of permanent and fixed-term contracts is set out as part of the Labour Code (last updated in January 2015) and the Law on Temporary Agency Work (last updated in January 2013).[6] Employment relations are almost entirely regulated by the law, while little room is left for negotiations between social partners (i.e. trade unions and employers' organisations). Indeed, collective agreements apply to only around 10% of employees (Vidovic, 2013; Bagdanskis and Usonis, 2011).[7]

Inherited from soviet labour law principles, Lithuanian EPL remains today characterised by overall strict employment protection legislation (Bagdanskis and Usonis, 2011; Gruzevskis and Blažienė, 2007). Since the early 2000s, Lithuania has undergone significant reforms to liberalise permanent contracts on the background of increased regulation of temporary contracts and collective dismissal (Muravyev, 2010). Going forward, Lithuania aims at introducing more flexible EPL on both permanent and temporary contracts, while also ensuring that workers who are displaced receive the necessary social protection and assistance to find new jobs – an approach which many observers in Lithuania refer to as the "new social model" based on "flexicurity".

Workers on permanent contracts benefit from relatively high levels of protection

Lithuanian workers under permanent contracts today benefit from a relatively high level of protection against individual dismissal. In case of justified/fair dismissal, notice periods are comparatively long measured against the benchmark of the OECD countries, while severance pay is relatively generous, especially for workers with short job tenure (including possibly the youth). Indeed, not only the employers need to provide two months written notice to the employee (regardless of job tenure) – which is relatively high by OECD standards; in addition, the length of the notice is much longer (four months) for some categories of workers, such as youth under 18. Furthermore, during the notice period workers are allowed to take at least 10% of the normal working time off to look for a new job (Gruzevskis and Blažienė, 2014), which further increases the cost of dismissing workers. Severance pay in Lithuania is also relatively high and spans from a minimum of one monthly wage (for tenure of less than 12 months), to a maximum of six monthly wages (for tenure of more than 20 years).

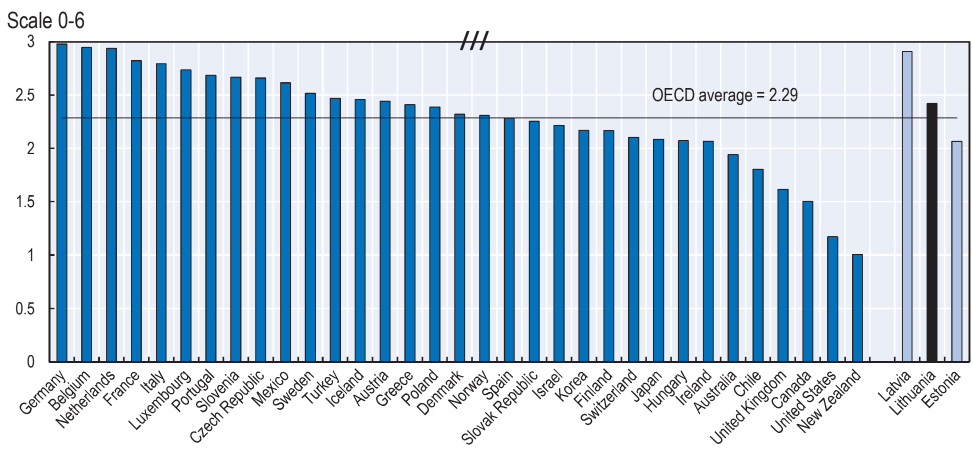
Similar to many OECD countries, provisions for collective dismissal in Lithuania require additional notification procedures. In general, employers need to notify third parties (typically workers’ representatives and public employment services) and/or engage in negotiations with trade unions (OECD, 2013). In Lithuania, both additional provisions apply: employers dismissing a large number of workers at a time must notify the Local Labour Exchange office, after consultations with employees' representatives. By contrast, both additional provisions are found in only few OECD countries.[8]

The definition of unfair dismissal is broad in Lithuania, and reinstatement obligations following unfair dismissal are relatively restraining. If the case is taken to Court and dismissal is recognised as unfair, the judge can order that the worker be reinstated. In this case, the worker is entitled to wage arrears and social security contributions should be paid as if he/she had never been dismissed. In case the Court recognises dismissal as unfair but decides to terminate the employment contract, the employer also needs to pay the severance pay (on the top of the wage arrears and SSCs). While this is generally the case in most OECD countries (OECD, 2013), it may still represent a strong disincentive to hiring and firing. Having said that, in Lithuania workers have little time to bring the case to Court: the maximum time for lodging a claim is one month from the effective date of dismissal – whereas the median maximum time is two months across OECD countries (OECD, 2013).

The length of trial periods is another aspect of the EPL that is likely to affect the hiring of youth. During trial periods, the payment of severance pay does not apply and the employer can dismiss workers rapidly with no costs. However, trial periods in Lithuania are relatively short: they can last three months compared to an OECD average of five months (OECD, 2013). Furthermore, employers in Lithuania can use trial periods only in limited circumstances. For example, trial periods are not allowed when hiring people younger than 18, when transferring employees between employers, when recruiting through official tender or elections, or when hiring those who have passed the qualification examinations for the position (ILO, 2011).

All in all, assessing the above regulatory components from an international comparative perspective suggests that employment protection legislation on permanent contracts (for both individual and collective dismissal) is relatively strict by OECD standards in Lithuania (Figure 2.5).[9] On a scale that goes from 0 (least strict) to 6 (most strict), Lithuania scores 2.42, which is above the OECD average of 2.29. As shown in Figure 2.4, EPL on permanent contracts in Lithuania is stricter than two-thirds of OECD countries. Compared to the neighbouring Baltic countries, employment protection legislation on permanent contracts is much stricter in Lithuania than in Estonia (2.07), but more lax than in Latvia (2.91).

Figure 2.4. Employment protection legislation on regular employment (individual and collective dismissal), Lithuania, Baltic and OECD countries, 2013[a]



Note: Data for Lithuania refers to 2015.

Source: OECD Employment Protection Database, http://stats.oecd.org/.

It is noteworthy that although EPL on permanent contracts is relatively strict in Lithuania, there is evidence of weak enforcement (European Commission, 2015; Muravyev, 2010; Bagdanskis and Usonis, 2011; OECD, forthcoming). Many contracts are terminated by "agreement between the parties" (which does not entail the payment of severance pay), rather than on the initiative of the employer without any fault on the part of the employee (Gruzevskis and Blažienė, 2014). Indeed, between 2010 and 2013 only less than 10% of total dismissed workers received severance pay (European Commission, 2015).

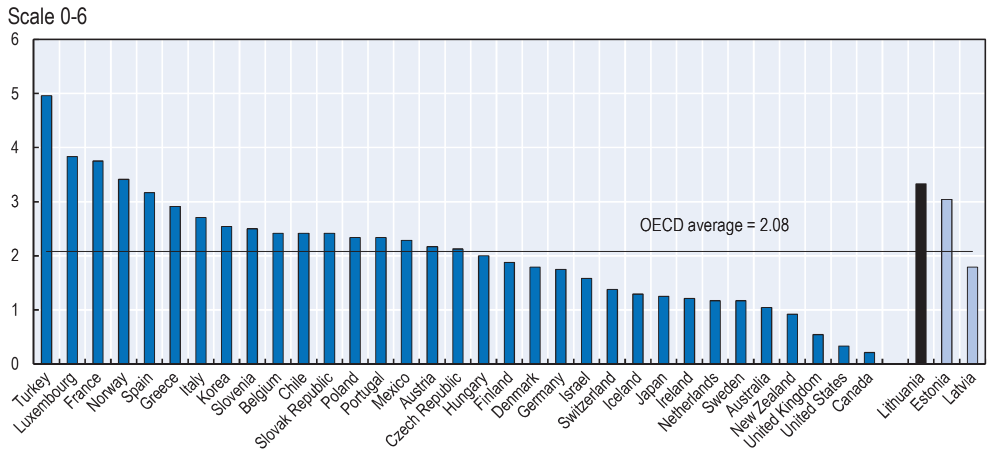
Employment protection legislation on temporary employment is very strict

Employment protection legislation on temporary employment is also very strict in Lithuania. First and foremost, firms can conclude temporary contracts only under limited circumstances (e.g. for seasonal and project work) and can in no case use fixed-term contracts for work that is of a permanent nature.[10] By contrast, in more than half of OECD countries, no justification is required to hire workers under fixed-term contracts, at least for the first contract (OECD, 2013).

Moreover, regulation on renewals and prolongations is rather strict in Lithuania. Even though there are no legal restrictions on the number of renewals – provided that the maximum cumulative duration of five years is respected – the legislation contains provisions that make it difficult to extend a fixed-term contract. For example, after the expiration of a temporary contract, the employment contract is automatically converted into a permanent one. Furthermore, if a temporary contract is terminated, but within one month from the day of its termination another fixed-term employment contract is concluded with the dismissed employee for the same work, such a contract shall be recognised as permanent.

Overall, employment protection legislation on temporary contracts in Lithuania is strict by international standards (Figure 2.5). Lithuania scores 3.33 on the OECD employment protection legislation indicator on temporary contracts, which is well above the OECD average of 2.08, and above the neighbouring Baltic countries (3.04 in Estonia and 1.79 in Latvia). Across the OECD, only few countries (notably France, Luxembourg, Norway and Turkey) have more rigid EPL on temporary contracts than Lithuania. Partly as a result of strict regulation on temporary contracts, temporary work is very uncommon in Lithuania. As shown in Chapter 1, temporary employment affects only around 8.5% of all employed youth – compared to an OECD average of 39.8% and 43.6% in the European Union – and is virtually inexistent among the low-skilled and adults (OECD, 2014).

Figure 2.5. Employment protection legislation on temporary contracts, Lithuania, Baltic and OECD countries, 2013[a]



Note: Data for Lithuania refers to 2015.

Source: OECD Employment Protection Database, http://stats.oecd.org/.

Moving regulation on temporary and permanent contracts more in line with one another

As in other countries, the combination between high costs related to individual and collective dismissal, relatively short trial periods, and excessively strict employment protection legislation on temporary contracts is likely to act as a burden to Lithuanian firms and possibly a barrier to the employment of youth workers. According to the *Global Competitiveness Report 2014-2015*, restrictive labour regulation is considered to be the second most problematic factor for doing business in Lithuania (Schwab and Sala-i-Martín, 2014).

The ongoing reform of the Labour Code is an important step aiming to tackle these challenges. The main aim of the new draft is to ease employment protection legislation by introducing more flexible contract arrangements, easing hiring and dismissing procedures, and making working time arrangements more flexible. The draft is currently under discussion and awaiting approval.

Concerning open-ended contracts, the draft proposes to shorten notice periods for dismissals and reduce severance pay considerably. Notice periods would be shortened from two months to two weeks for workers with job tenure of less than a year, and one month for workers who have worked for more than a year. However, the length of the notice period would be doubled for employees who would reach retirement age in less than five years, and tripled for those who would reach retirement age in less than two years. Severance pay is also reduced to half average monthly wage for employment relations of less than one year, and one average monthly wage for employment relations of one year or more.

Many features of the reform of the Labour Code concerning permanent contracts are in line with international practices. Indeed, in the past decade, and particularly since the onset of the crisis, many OECD countries have introduced more flexibility in the EPL around permanent contracts. Since 2008, more than one-third of OECD countries undertook some relaxation of regulations on either individual or collective dismissals. Overall, the main areas where a loosening of employment protection took place were the limitation of the possibility of reinstatement in the case of unfair dismissal; the extension of the duration of the trial period; the reduction of the length of the notice period; and the reduction in severance pay (OECD, 2013).

Strict EPL can be particularly burdensome in Lithuania where there are mainly small businesses,[11] for which the costs associated with overly strict labour regulation may be particularly high. In fact, small firms are less likely to have specialised human resources departments to deal with the complex process of complying with regulation. Furthermore, the fixed cost of dismissing a worker (incorporating severance pay and possibly compensation and legal costs if the dismissal is disputed) is relatively more pronounced for smaller than larger firms as it accounts for a higher share of the wage bill. Small firms also have less scope for internal redeployment of workers than larger firms.

In this context, the new draft Labour Code aims to reduce the strictness of employment protection legislation for smaller firms. For example, small firms, with less than ten employees, would be entitled to set a longer trial period (six months instead of three). In addition, they would benefit from shorter dismissal period, be entitled to pay lower wages (up to 30% lower per-diem rate), and allowed to refuse to grant part-time contracts to workers or provide paid education leave. Firms with less than five employees would be entitled to even shorter dismissal periods and reduced severance pay, and exempted from paying annual leave to workers with job tenure shorter than a year.

Similarly, many OECD countries also exempt small firms from some or all employment protection requirements (Venn, 2009). Most commonly, small firms are exempt from additional notification or procedural requirements when undertaking collective dismissals. In addition, several countries reduce or remove severance payments, notice periods or the risk of being accused of unfair dismissal for small firms. However, the international experience suggests that a careful balancing is needed when exempting small firms from employment protection requirements. Indeed, too lax a regulation for small firms compared to larger firms could provide an incentive for companies to stay small; hire non-standard workers; shift higher dismissal costs into employees' wages; or split operations in order to remain below the threshold (Venn, 2009).

Although traditionally temporary contracts were (and still are) treated as worsening employees' rights in Lithuania (Bagdanskis and Usonis, 2011), the international evidence suggests that the use of temporary contracts can provide opportunities for both firms and workers (OECD, 2010; 2014). From the employers side, firms may use temporary contracts to possibly reduce labour costs or as a screening device for future hiring. Temporary jobs can also provide a useful buffer of adjustment and flexibility for firms in the case of uncertain or fixed-term activity (OECD, 2014). From the workers perspective, temporary jobs may reflect a voluntary choice or may provide an opportunity to those with limited work experience, such as youth, to get a foothold in the labour market. Indeed, for many youth temporary contracts are more often a stepping stone to a permanent contract than a dead end (OECD, 2010; 2014).

The new draft of the Labour Code in Lithuania allows for more flexible legislation of temporary contracts. Particularly, employers would be allowed to conclude temporary contracts also for work positions that have a permanent nature. Furthermore, the new Labour Code would introduce a whole set of new types of more flexible contracts, such as training and apprenticeship contracts, while also providing more flexible regulation of part-time work.

However, the liberalisation of temporary contracts must be carefully balanced to avoid abuses from employers and prevent the creation of a dual labour market. In the past decades, and particularly during the 1990s, many OECD countries have heavily liberalised fixed-term contracts while maintaining legislation around permanent contracts unchanged, thereby increasing labour market segmentation (OECD, 2014). Large disparities of job quality across contract types risk to create a system for which outsiders tend to move from one temporary contract to another while insiders enjoy higher protection and greater job stability. At a macroeconomic level, dual labour markets induce large adjustments in employment levels during recessions, increasing the volatility of labour markets and public budgets (e.g. Cahuc and Zylberberg, 2008). The evidence analysis also suggests that countries that have relaxed regulations on temporary contracts while maintaining stringent restrictions on regular contracts, have indeed experienced slower productivity growth (Boeri and Garibaldi, 2007; Bassanini, Nunziata and Venn, 2009; Dolado, Ortigueira and Stucchi, 2012).

The experience of some OECD countries suggests that if Lithuania indeed decides to increase the flexibility on temporary contracts it should pursue this in a co-ordinated manner. As a priority, this will require recourse to complementary, accompanying measures to avoid abuses and prevent the creation of a dual labour market. One way to do so would be to consider introducing a *unified contract* and apply similar termination costs to all contract types. A welcome step in Lithuania is that the new draft of the Labour Code proposes to introduce similar termination costs to different contract types. According to the new draft, the new regulation on severance pay – entailing the payment of one average monthly wage – would apply indistinctly to all employment relations of one year or more, including employees on fixed-term contract.

While the move toward regulations on temporary and permanent contracts that are more in line with one another is likely to encourage firms to hire more, including more youth, it will be important to ensure that the reform of the Labour Code includes measures to strengthen the evaluation framework to assess progress and to identify possible areas for further improvements. As in other countries, this could involve the creation by the Ministry of Social Security and Labour of an independent evaluation structure supported by the research and expert community. This is a key to both identify which measures should be expanded, adapted or ended, and which intervention might work best if employed as a package in combination with other measures.

Notes

1. The labour cost is defined as the sum of gross wage earnings, employers' social security contributions and payroll taxes.
2. For the calculation of the tax wedge, the OECD uses the rate of 31.1% as specified in OECD (2015a). This takes into account occupational injuries and occupational disease social insurance contributions.
3. Public works in Lithuania have an atypical nature when compared to "regular" public works as generally referred to by OECD standards: they are a form of wage subsidy paid to private or public employers, but at the same time they have the same temporary nature and serve the same scope of alleviating poverty as "regular" public work programmes.
4. These hiring incentives are targeted at many disadvantaged groups, including youth.
5. BTEA is the part of income that is exempted from personal income taxes. See Box 2.2 for further information.
6. Temporary work agency (TWA) employment was first regulated in Lithuania in 2011 with the Law on Temporary Agency Work. TWA employment contract can be either fixed-term or open-ended. The rules regulating TWA employment closely resemble those regulating open-ended and fixed-term contracts in the Labour Code. Before the adoption of the Law on Temporary Agency Work in 2011, this form of employment was particularly unpopular because it was not regulated and lacked effective monitoring mechanisms (Bagdanskis, 2011).
7. Across OECD countries, collective bargaining can be much more widespread and covers from less than 20% of the workforce in Japan, Korea and the United States, to 90% or more in Austria, Belgium, Finland, France, Slovenia and Sweden (Venn, 2009).
8. Notably Australia, Belgium, Hungary, Iceland, Ireland, Japan, Mexico, Sweden, Switzerland and the United States (OECD, 2013).
9. The OECD Employment Protection Legislation indicator is used to measure the strictness of employment protection legislation for OECD countries and other emerging economies. This is a synthetic indicator that

quantifies the costs and procedures involved in hiring and dismissing workers on permanent contracts as well as fixed-term and temporary contracts. There are other policies and institutions besides employment protection legislation that affect labour market flexibility, including regulations on working hours and part-time contracts, as well as policies affecting wage settings that are not captured in the OECD indicator.

10. However, it should be noted that starting from 1 August 2010, there were a few temporary anti-crisis changes introduced into the Lithuanian labour law. One of them allows concluding fixed-term employment contracts for newly established positions if work is of permanent nature (Zabarauskaite and Blažienė, 2013; Bagdanskis and Macijauskienė, 2012). In particular: fixed-term employment contracts are allowed only for new jobs, i.e. those established after 1 August 2010; the number of fixed-term employment contracts cannot exceed 50% of all positions in the company; fixed-term employment contracts cannot be made with former employees dismissed by mutual employment termination agreement or on the employer's initiative without employee fault; fixed-term employment contracts for newly established positions may be concluded for a maximum period of two years ending no later than on 31 July 2015.

11. Micro enterprises represent around 90% of all firms in Lithuania (European Commission, 2013; OECD, Forthcoming).

References

Bagdanskis, T. (2011), "Implementation of EC Directive on Temporary Agency Work Into Lithuania Legislation", *Jurisprudence 2011*, Vol. 18, No. 3, pp. 1035-1053.

Bagdanskis, T. and R. Macijauskienė (2012), "Application of Different Types of Employment Contracts in Lithuania – Related Theoretical and Practical Problems", *Jurisprudence 2012*, Vol. 19, No. 1, pp. 249–267.

Bagdanskis, T. and J. Usonis (2011), "Problems of Introduction of Flexibility into Lithuanian Labour Law", *Jurisprudence 2011*, Vol. 18, No. 2, pp. 595-612.

Bartasevičius, V. (n.d.), "Counterfactual Impact Evaluation of the Active Labour Market Policies in Lithuania", presentation available at file:///C:/Users/Forti_A/Downloads/08_Vainius_Bartasevicius_Counterfactual%20impact%20evaluation%20of%20active%20labour%20market%20policies%20in%20Lithuania.pdf, accessed 20 May 2015.

Bassanini, A., L. Nunziata and D. Venn (2009), "Job Protection Legislation and Productivity Growth in OECD Countries", *Economic Policy*, No. 58.

Boeri, T. and P. Garibaldi (2007), "Two Tier Reforms of Employment Protection: A Honeymoon Effect?", *Economic Journal*, Vol. 117, pp. F357-F385.

Boockmann B., T. Zwick, A. Ammermüller and M. Maier (2012), "Do Hiring Subsidies Reduce Unemployment Among Older Workers? Evidence From Two Natural Experiments", *Journal of the European Economic Association*, Vol. 10, No. 4, pp. 735-764.

Broecke, S., A. Forti and M. Vandeweyer (forthcoming), "The Effects of Minimum Wages on Employment in Emerging Economies: A Literature Review", *OECD Social, Employment and Migration Working Paper*, forthcoming.

Cahuc, P. and A. Zylberberg (2008), "Optimum Income Taxation and Layoff Taxes", *Journal of Public Economics*, Vol. 92, pp. 2003-2019.

Dahlberg, M. and A. Forslund (2005), "Direct Displacement Effects of Labour Market Programmes", *Scandinavian Journal of Economics*, Vol. 107, pp. 475–494.

Dolado, J., S. Ortigueira and R. Stucchi (2012), "Does Dual Employment Protection Affect TFP? Evidence from Spanish Manufacturing Firms", *CEPR Discussion Paper*, No. 8763, London.

Ebeke, C. and G. Everaert (2014), "Unemployment and Structural Unemployment in the Baltics", *IMF Working Paper*, No. 14/153.

European Commission (2015a), *Country Report Lithuania 2015*, European Commission.

European Commission (2015b), "Council Recommendation on the 2015 National Reform Programme of Lithuania and delivering a Council opinion on the 2015 Stability Programme of Lithuania", European Commission.

European Commission (2014a), "Stimulating Job Demand: the Design of Effective Hiring Subsidies in Europe", *European Employment Policy Observatory Review 2014*.

European Commission (2014b), *Job Creation Incentives: How to Better Integrate Policies to Create Sustainable Jobs*, European Commission.

European Commission (2013), *SBA Fact Sheet 2013: Lithuania*, European Commission.

French Ministry of Labour (2015), *Emplois d'Avenir* [online], available: http://travail-emploi.gouv.fr/emplois-d-avenir,2189/presentation,2259/emplois-d-avenir,2189/rubrique-technique,2193/presentation,2278/presentation,16015.html, accessed 5 May 2015.

Gruzevskis, B. and I. Blažienė (2014), *First Safety-Net and Redundancy/Severance Payments in Lithuania*, European Employment Policy Observatory (EEPO).

Gruzevskis, B. and I. Blažienė (2007), "Lithuania", in S. Cazes and A. Nešporová (2007), *Flexicurity, a Relevant Approach in Central and Eastern Europe*, International Labour Organization, Geneva.

ILO – International Labour Office (2011), *National Labour Law Profile: Lithuania* [online], available: http://www.ilo.org/ifpdial/information-resources/national-labour-law-profiles/WCMS_158913/lang--en/index.htm, accessed 15 April 2015.

IMF – International Monetary Fund (2014), *Baltic Cluster Report*, International Monetary Fund Country Report No. 14/116.

IMF – International Monetary Fund (2007), *Republic of Lithuania: Selected Issues*, International Monetary Fund Country Report No. 07/137.

INVEGA – Investment and Business Guarantees (n.d.), *Support for the First Job* [online], available: http://www.invega.lt/en/services/support-for-the-first-job-invega.htm, accessed 31 March 2015.

Italian Ministry of Employment and Social Policies (2015), *Guida Incentivi all'Assunzione e alla Creazione d'Impresa*, Ministry of Employment and Social Policies.

Kangasharju, A. (2007), "Do Wage Subsidies Increase Employment in Subsidized Forms?", *Economica,* pp. 51–67.

Ministry of Social Security and Labour (2014), *Social Insurance Contributions* [online], available: http://www.socmin.lt/en/social-insurance-1975/social-insurance-contributions.html, accessed 16 April 2015.

Muravyev, A. (2014), "Employment Protection Legislation in Transition and Emerging Markets", IZA World of Labor 2014, No. 63.

Muravyev, A. (2010), "Evolution of Employment Protection Legislation in the URSS, CIS and Baltic States, 1985-2009", *IZA Discussion Paper No. 5365*, Bonn.

Nekrošius, I. and V. Petrylaitė (2010), *Social Security Law in Lithuania*, Kluwer Law International.

OECD (forthcoming), *OECD Economic Survey: Lithuania*, OECD Publishing, Paris.

OECD (2015a), "Benefits and Wages: Lithuania", Country chapter for OECD series, http://www.oecd.org/els/social/workincentives, accessed 3 April 2015.

OECD (2015b), "Minimum Wages after the Crisis: Making Them Pay", OECD, Paris, http://www.oecd.org/social/Focus-on-Minimum-Wages-after-the-crisis-2015.pdf.

OECD (2015c), *OECD Employment Outlook 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2015-en.

OECD (2014), "Non-regular Employment, Job Security and the Labour Market Divide", *OECD Employment Outlook 2014*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2014-en.

OECD (2013), "Protecting Jobs, Enhancing Flexibility: A New Look at Employment Protection Legislation", *OECD Employment Outlook 2013*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2013-en.

OECD (2011), "G20 Country Policy Briefs: Turkey. Supporting Employment through Reduced Social Security Contributions", OECD and ILO 2011 on occasion of the Meeting of Labour and Employment Ministers, 26-27 September 2011, Paris.

OECD (2010), "Removing Demand-side Barriers to Youth Employment", *Off to a Good Start? Jobs for Youth*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264096127-en.

OECD (2004), "Employment Protection Regulation and Labour Market Performance", *OECD Employment Outlook 2004*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2004-en.

PPMI – Public Policy and Management Institute (2015), *Counterfactual Impact Evaluation of ESF-funded Active Labour Market Measures in Lithuania*, Public Policy and Management Institute.

Scarpetta, S. (2014), "Employment Protectione", *IZA World of Labor 2014*, No. 12, Bonn.

Schwab, K. and X. Sala-i-Martín (2014), *The Global Competitiveness Report 2014-2015*, World Economic Forum.

Swedish Ministry of Employment (2014), "Youth Employment Policies in Sweden – The Swedish Response to the Council Recommendation on Establishing a Youth Guarantee", Ministry of Employment.

Venn, D. (2009), "Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators", *OECD Social, Employment and Migration Working Papers,* OECD Publishing, Paris, http://dx.doi.org/10.1787/223334316804.

Vidovic, H. (2013), *Labour Market Developments and Social Welfare*, Vienna Institute for International Economic Studies.

Wageindicator (2015), *Lithuania* [online], available: http://www.wageindicator.org/main/salary/minimum-wage/lithuania, accessed 04 May 2015.

Welters, R. and J. Muysken (2006), "Employer Search and Employment Subsidies", *Applied Economics,* Vol. 38, No. 12, pp. 1435-1448.

World Bank (2005), "Special Topic: Labour Taxes and Employment in the EU8", *World Bank EU-8 Quarterly Economic Report*, Part II, April.

World Bank and IFC (2013), *Enterprise Surveys: Lithuania Country Profile 2013*, World Bank and the International Finance Corporation.

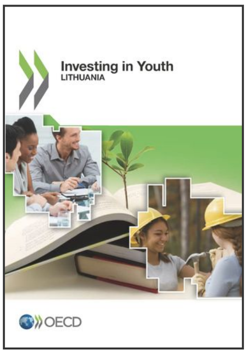
Zabarauskaite, R. and I. Blažienė (2013), "Lithuania: Young People and Temporary Employment in Europe", European Monitoring Centre on Change 2013 [online], available: http://www.eurofound.europa.eu/observatories/emcc/comparative-information/national-contributions/lithuania-young-people-and-temporary-employment-in-europe, accessed 5 May 2015.

Database references

OECD Earnings Database, http://stats.oecd.org/.

OECD Employment Protection Database, http://stats.oecd.org/.

OECD Public Sector, Taxation, and Market Regulation Database, http://stats.oecd.org/.



From:

Investing in Youth: Lithuania

Access the complete publication at:

https://doi.org/10.1787/9789264247611-en

Please cite this chapter as:

OECD (2016), “Removing demand-side barriers to youth employment in Lithuania”, in *Investing in Youth: Lithuania*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264247611-6-en

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area. Extracts from publications may be subject to additional disclaimers, which are set out in the complete version of the publication, available at the link provided.

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at http://www.oecd.org/termsandconditions.