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PUBLIC SECTOR'S SUBSIDIES TO BUSINESSES – SUITABILITY VALUATION OF LABOR MARKET SUPPORT MEASURES

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Abstract. This scientific article explores the growing unemployment rate and its regulation through government's subsidies to businesses since it is one of the major economic issues countries currently face. The number of various State-run job creating programs is increasing in Lithuania as in many other countries. This is an important factor to all businesses, since labor costs often comprise a large part of company's expenses. The analysis of the labor costs generally are associated with two aspects – tax burden related to wages is important not only to companies, which try to minimize their expenses, maximize profit and achieve operational effectiveness, but also to public sector, which tries to collect more tax revenues to national budget and different funds. Therefore, the authors of this article identify State-run job creating programs and perform their comparative analysis. The results of the performed analysis show, that plethora of job creating programs exist in Lithuania, the implementation and use conditions of which are provided by different public sector institutions. Therefore, with the help of comparative analysis results, authors present specific recommendations to private sector in respect to effectiveness and impact of public sector's support.

Keywords: Labor market support, public sector's subsidies to businesses, hiring subsidies, taxation, labour market.

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1. Introduction

World-wide economic downturn generated the need in most businesses to decrease their expenses, and labor costs generally become the main target. One of the business areas most affected by deteriorating economic conditions were wages, and business entities behaved in one of two ways - often decreasing wages, but also, as seen from statistical data analysis, dismissing employees. These decisions directly influenced all main macroeconomics issues in the country, such as unemployment, youth emigration, etc. Therefore, active job creating policy measures are seen not only as an important Lisbon strategy implementation measures, but also as one of the most effective control measures of unemployment (Kwiatkowski, Kwiatkowska 2006, Henriquez *et al.* 2002). It should be noted that labor market support measures in the practice of European Union countries are used more and more to battle unemployment. Majority of Eurozone countries encourage entrepreneurship, aid in setting up new businesses, and provide loans with favorable conditions to sustain the existing ones, etc. (Küttim *et al.* 2011). Meanwhile, the main measures of public sector's subsidies to businesses in order to improve labor market indications in Lithuania are: labor market support through job creation subsidies and hiring subsidies, new job skills support, job rotation and self-employment. Nevertheless, suitability and effectiveness of these measures rise

heated discussions among representatives of public and private sectors. However, the scientific research in this field is not well developed among Lithuanian scientists, even though discussed by many: Dumčiuvienė, Stravinskas 2012; Okunevičiūtė-Neveauskienė, Moskvina 2010; Žalimienė 2011; Gražulis, Gruževskis 2009. Therefore, the object of this research is the existing measures of labor market support in Lithuania.

The aim of the research is to evaluate the suitability of labor market support measures initiated by Lithuania's public sector in existing economic conditions.

In order to achieve the research aim, the following objectives are raised:

- To analyze the need of labor market support measures;
- To perform a comparative analysis of wage related support measures to businesses by public sector;
- To foresee and evaluate the suitability of labor market support measures.

The article includes analysis and synthesis of empirical research and economic literature, practical study of public sector's subsidies to businesses in respect to implementation and use of labor market support measures in practice.

2. The need for labor market support measures

Evaluation, suitability and benefits of the new employment support measures became especially relevant in 2009 when a new Law on Employment Support came into force. Another important task is the creation and development of the continuous monitoring system (Jankauskas, Šeputienė 2011). The implementation of these measures is already monitored, nevertheless the search for more refined techniques that can help evaluate the impact and effectiveness of active labor market policies, continues. It needs to be noted, that the effect of labor market support measures is indeed felt in Lithuania, according to Neubäumer (2010) other countries are not exceptions as well. The growing unemployment, emigration, other social factors and their dynamics in Lithuania, show that public sector's subsidies to businesses to support labor market are needed (Figure 1).

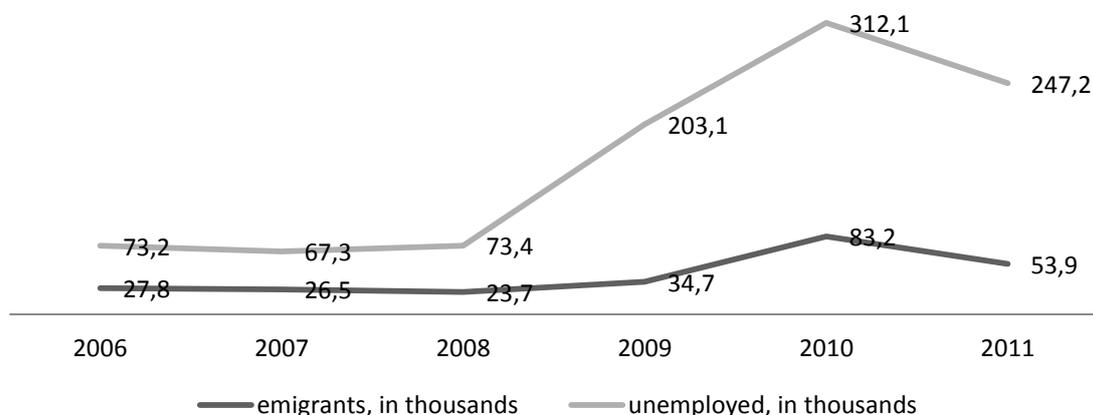


Fig.1. The dynamics of emigration and unemployment numbers in Lithuania, 2006-2011
Source: Lithuanian Department of Statistics (2013)

Continuously growing emigration and unemployment have direct effects on population aging in Lithuania, since the working-age population and the number of insured by social security contributions is rapidly decreasing. This also directly determines other problems in the country, such as decrease in the collection of taxes to national budget and other funds (Lapinskienė, Tvaronavičienė 2009). State is forced to shrink pensions to elderly, since the budget of State's Social Insurance Fund is running a continuous deficit and monetary costs of pensions are mounting faster than revenues. Many businesses started to pay wages illegally this way contributing to the shadow economy, which in turn also reduces the collection of social insurance funds (Jakštonytė 2009a). Due to these reasons and their impact, State has taken action by creating and implementing labor market support programs. Nevertheless, the programs did not receive the expected interest from business entities and the majority of companies operating in Lithuania during the analyzed period tried to reduce their costs by decreasing wages or the number of employees. The data from Lithuanian Department of Statistics shows that average monthly earnings have decreased both, in private and public sectors since 2008. The average monthly gross earnings in the country (including individual

companies) have decreased from 2151.7 Lt per month in 2008, to 1990 Lt per month in 2011. Taxes from wages generate a large part of State's tax revenues in most developed and developing countries, such as Baltic states (Haufler *et al.* 2009) (Fig.2).

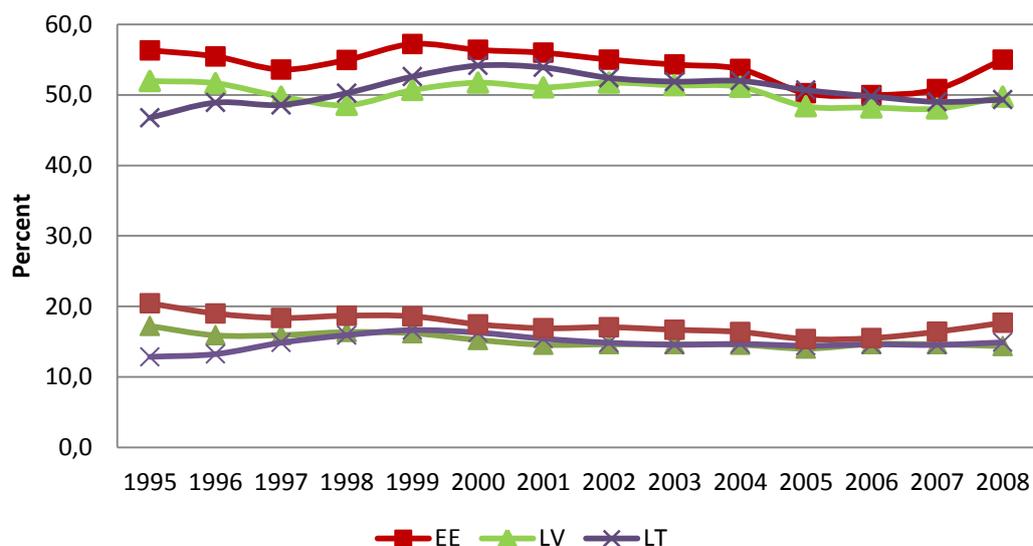


Fig.2. Taxes collected from wages in percentage of overall tax revenue (top group) and as a percentage of GDP (bottom group) in Baltic countries
Source: Eurostat (2013)

As seen from Figure 2, taxes collected from wages have a comparatively similar weight in overall national tax revenues in all of the Baltic countries. Furthermore, taxes collected from wages as a percentage of GDP also follow the same trend in all Baltic countries. Conclusively, all Baltic countries, not only Lithuania, should face similar problems and the need for labor market support measures. Therefore, this research is at great importance to all Baltic countries.

3. Comparative analysis and suitability valuation of wage related support measures to businesses by public sector

There are plenty of wage related public sector's support measures to private sector. Nevertheless, they mostly apply to businesses, which employ a registered unemployed person or a person who is notified about dismissal (Blažienė, Ruževskis 2010). If the company uses this tax relief for the employee who earns not more than 1600 Lt per month, then 50, 60 or 75 percent (depending on the status of the employed person) of contributions to State's Social Insurance Fund are compensated for 6 months or one year. There are cases when the employer wants to reduce costs by taking advantage of the tax relief and asks the potential employee to register with labor exchange office before employing him. This type of legal cost cutting is almost as costly to the national budget, as tax avoidance through illegal wages (Kitao *et al.* 2011). Nevertheless, it fosters the understanding and development of taxation culture in the country (Giriūnienė 2012). Although it is doubtful that Lithuania will soon be dominated by taxation culture, which currently exist in the Scandinavian countries and all residents and businesses will voluntarily pay taxes without concealing part of them. Therefore, other ways to minimize work-related taxes exist in the country. From a business perspective, the most beneficial seems to employ persons without any previous work experience (Okunevičiūtė-Neveauskienė, Pocius 2011). The company for employing such employees, if their earnings do not exceed 2400 Lt per month, is exempt from paying pension social insurance for these employees for up to one year. Therefore, taxes for the employer for that particular employee

are reduced from 30.98% to 7.68%, besides employee does not have to pay 3% of pension social insurance (Brazienė, Mikutavičienė 2013). Nevertheless, despite the financial advantage not all employers willingly employ persons without any work experience, since training, professional development and other expenses need to be taken into account as well. However, from practice we can see that taking up a new, inexperienced employee can benefit the company, since he can be trained into a good specialist at a lower cost (Jacobs *et al.* 1992). The duration and the size of funding of the financed wages, expressed in percentage of an overall wage and taxes on it, are the main criteria in the comparative analysis (Gesine 2010). Therefore, the aim of this analysis is to select the optimal options under both criteria and provide an overall conclusion about the best ways (with longest and largest funding) for public sector to subsidize businesses to support labor market (Table 1).

Table 1. Comparison of labor market support measures

	Public services	New job skills support	Subsidized hiring	Job rotation
Duration	Up to 6 months	<ul style="list-style-type: none"> Up to 12 months, when employing persons without any previous experience related to their obtained qualification; Up to 5 months, when employing persons from other focus groups. 	Up to 6 months	Up to 12 months
Funding	<ul style="list-style-type: none"> wage earned by employed person for the time actually worked, calculated in accordance with Government's approved minimum hourly wage; compulsory state social insurance contributions by insurer, calculated from earned wage; monetary compensation for unused vacation, including the amount of compulsory state social insurance contributions by insurer 	<ul style="list-style-type: none"> 50% from calculated funds, when employing persons without any previous experience related to their obtained qualification, long-term unemployed, who have not worked for 2 or more years before registration with labor exchange, persons after vocational rehabilitation program, who are diagnosed with 45-55% working capacity and are notified about dismissal from work bus are still not at the retirement age; 60% of calculated funds, when employing persons after vocational rehabilitation program, who are diagnosed with 30-40% working capacity; 75% of calculated funds, when employing persons after vocational rehabilitation program, who are diagnosed with up to 25% working capacity. 	50, 60 or 75 percent from calculated wage	75 – 50, 40 percent from calculated funds, when previously unemployed are employed

Source: Mikutavičienė, Brazienė 2013; LR Užimtumo rėmimo įstatymas 2006, 2010; Darbo rinkos paslaugų teikimo sąlygų ir tvarkos aprašas 2009; Aktyvios darbo rinkos politikos priemonių įgyvendinimo sąlygų ir tvarkos aprašas 2009, 2010

Preliminary comparative analysis of public sector's subsidies to businesses shows that hiring subsidies for unlimited time are possible best option. Nevertheless, this is possible only by employing disabled, who have up to 25% working capacity or have a severe disability level and disabled who have 30-40% working capacity or average disability level. To receive subsidies for up to 12 months, company has to employ: persons who were on social welfare before they turned 25; persons starting their work according to acquired qualification of social worker assistant, when their employment creates work opportunities to other unemployed with family obligations; pregnant women, mothers (adoptive mothers) or fathers (adoptive fathers), guardians, caretakers and other persons raising children (adoptive child) up to 8 year old or a disabled child (adoptive child) up to 18 years old (before 2005 July 1 recognized as a disabled child), persons who look after sick or disabled family members, who, according to Ministry of Social Security and Labour, require constant care (Moskvina 2008). Also up to 12 months, when employing persons without any previous work experience related to their obtained qualification or through job rotation program. The largest compensation, up to 75% from the wage and related taxes can be deducted, through new job skill support program, when employing persons after vocational rehabilitation program that are diagnosed with up to 25% working capacity, besides the company can deduct additional 20% for employees' training.

Conclusively, we can say that it pays off for businesses to employ disabled who are diagnosed with up to 25% working capacity or severe disability level and disabled who have 30 – 40% working capacity or average disability level (Petrauskas, Bilevičienė 2007). This way companies can receive up to 75% funding of the wage related expenses for 12 months to unlimited time, of course if the company can satisfy the posed conditions by the State. Nevertheless, these conclusions are only theoretical, since statistics shows that during the period January – August 41.9 thousand people participated in active labor policy measures: 5.9 thousand began vocational training programs, 35.2 thousand participated in supported employment programs, 22.4 thousand out of them were temporarily employed in public services and 8.3 thousand were employed through subsidized hiring. However, full analysis requires not only the identification of labor market support measures, but also their impact analysis which is much more important and significant (Brixiova 2011). Market analysts who research taxes related to wages and business environment note, that large wage related tax burden on businesses not only inhibits the legal economy, but encourages tax evasion and shadow economy (Jakštonytė 2009b). The following authors have discussed wage taxation and its perspectives in Lithuania: Gedvilienė and Šalkauskienė 2009; Jukonienė and Šapalienė 2011; Mackevičius *et al.* 2006, etc. Nevertheless, not enough attention in their publications is given to various programs and other factors, which enable businesses to minimize the wage related tax burden, this way finding a point of balance between employer and employee tax burdens (Gylis 2006). This particular way of evaluating labor market support measures initiated by the public sector, would be the most appropriate way to distinguish their effects, and determine whether they are truly effective and attractive to business entities and to what extent. New subsidies and measures implemented to minimize companies' tax burden related to wages require a thorough analysis of which option would be the most beneficial not only to businesses, but also to employees and the State (Tvaronavičienė 2006). Thus, the lowest tax burden related to wages, in other words the best option for a company is to employ youth without previous work experience (Fig.3).

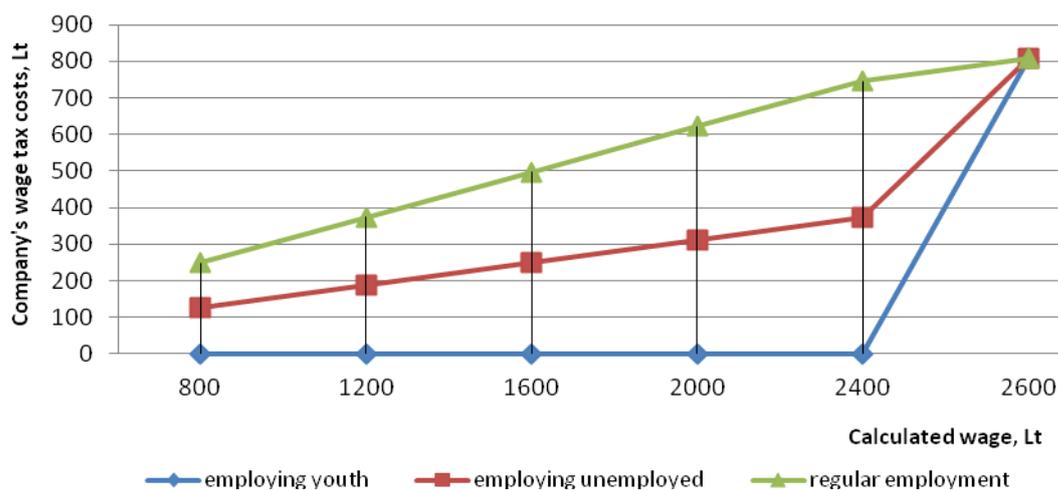


Fig.3. Tax burden of a company when taking advantage of a public sector's subsidies to businesses through labor market support measures

Source: compiled by the author

As seen from the figure above, the greatest benefit by the company will be attained if it employs youth without previous work experience with wage up to 2400 Lt per month. Nevertheless, once employee's wage reaches above the mentioned amount, the tax burden of employing youth without work experience will equal the tax burden of employing regularly, without any tax reliefs. However, the performed analysis has shown that there is no single best way to promote labor market in the country by decreasing tax burden related to wages for businesses. Nevertheless, due to currently enforced laws and other legal acts regulating taxes, the least amount paid by employers in the form of taxes related to wages is when a young person, without any previous work experience is employed and his wage does not exceed 2400 Lt per month. There are no limits in perfecting tax burden minimization. Therefore, the search for the option, which would decrease company's tax burden and would be beneficial to the employee as well must continue, since the above discussed subsidies are only temporary minimization and promotion measures (Žukauskas 2002). We should also stress, that government's support, various programs and foreseen tax reliefs for businesses, to stimulate labor market have to be assessed not only from employers' perspective, but also from employees' perspective (Figure 4).

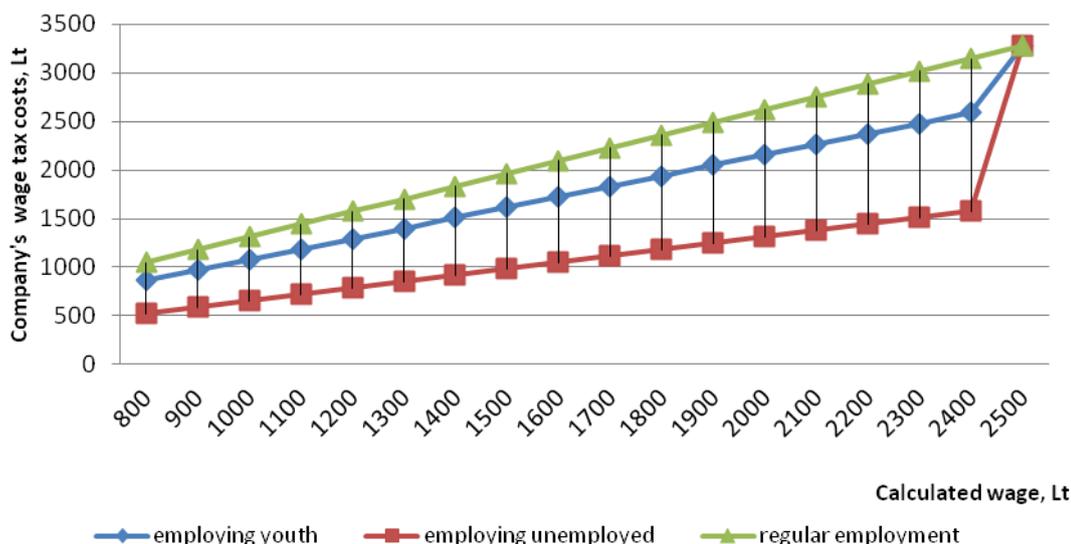


Fig.4. Employees wage when taking advantage of a public sector's subsidies to businesses through labor market support measures
Source: compiled by the author

When employees wage range from 1200 Lt to 2400 Lt per month, employee's net earnings are greatest when he is employed for the first time. The assumption is made that the company cannot receive two different tax reliefs, for instance to employ an unemployed, who at the same time does not have any working experience and is a new labor market participant. In this case only one of the tax reliefs will apply. If the company selects an option to employ a young person without previous work experience, its expenses would be reduced, but not minimized. As mentioned before, for a business to employ an unemployed person is financially better, since for one year the wage related expenses would be lower than employing a young person without work experience. Therefore, the most attractive option would be to employ an unemployed person. This way the highest benefit would be achieved by a company and employee. At the same time, this should also slow the emigration from the country, which as seen from statistical data analysis, is mostly comprised of youth up to 30 years old. Nevertheless, we should not forget to evaluate suitability of the public sector's subsidies to businesses through labor market support measures in creating benefits to the State. Even though this valuation is very important, we need to note, that it is rather complex, since there are no possibilities to evaluate the real implementation cost and benefit to the State of created and sustained labor market supporting measures. Therefore, their suitability and effectiveness can be evaluated only from business and employee perspectives.

Conclusions

The first, currently there are quite a few labor market support measures offered to businesses, which usually cover part of wage paid and taxes related to it. Nevertheless, it only temporarily improves the labor market indicators. Businesses feel this relief only temporarily as well, since these measures do not directly batter declining demand, rising prices and high overall tax levels. Therefore, most often at the end of the program employees are dismissed or their wages are reduced.

The second, the proposed labor market funding in Lithuania is oriented towards long-term unemployed, inexperienced or disabled, often low skilled workers. Theoretically it is sound to employ based on job rotation, new job skill support programs, where it is most beneficial to employ disabled, diagnosed with up to 25% working capacity or with a severe disability level and disabled who have 30 – 40% working capacity or average disability level. The company can obtain up to 75% funding of the wage related expenses for 12 months to unlimited time, of course if it can satisfy the posed conditions by the State. Nevertheless, in practice the most effective were public service programs and subsidized hiring, since employers often require fully able and energetic employees. This might be due to physically demanding positions or unsuitable working conditions for disabled people, etc.

The third, according to currently enforced laws and other legal acts regulating taxes the best way for businesses to minimize costs associated to wages and related taxes is to purchase labor force as a service from a business license holder or to use public sector's subsidies to businesses and employ a young person without previous work, while paying him not more than 2400 Lt per month. Nevertheless, once employee's wage reaches above the mentioned amount, the lowest tax burden can be obtained by employing the unemployed. However, besides these active labor market support measures, business in general should be supported through subsidizing the creation of new businesses.

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