ANNEX 2. Reform of Lithuania’s social model: regulation of labour relations

Businesses continually hire and dismiss employees. This allows them to keep up with the changing economic and competitive environment, developments in production technology, etc. However, this frequently happens at the expense of the dismissed employee: they lose their source of income, professional skills and feel a sense of instability and tension due to their deteriorating financial circumstances. Thus, governments try to balance the need for businesses to employ and dismiss employees freely and the need to protect employees from experiencing the hardships of unemployment. The Annex discusses how these aims were reconciled in Lithuania, and how the current state of affairs will be affected by the new social model. The primary focus will be on amendments to the Labour Code, as it is these changes that provoked the most discussion in the public arena.

1. Social models in other countries

The balance between the aforementioned freedom for businesses and the protection of employees is typically achieved through the use of three elements: restrictions on hiring through temporary employment contracts and dismissal (reducing the number of employees fired); unemployment benefits (replacing the employee’s lost income); and active labour market policies (ALMPs; helping fired employees find employment). Combinations of these elements — social models — as applied by developed countries, can be classified into three groups (Blanchard, 2013):

- **The Anglo-Saxon model.** Hiring and dismissal restrictions are low, and the unemployment social insurance system is not generous. This results in intense hiring and firing, shorter unemployment duration and low unemployment rates.

- **The Nordic model** (also known as the flexicurity model). Hiring and dismissal restrictions are moderately strict or strict, the unemployment insurance system is generous, however, unemployment benefits depend on an individual’s efforts to find employment, ALMPs play a significant role. This allows the economy to reallocate labour resources and results in low unemployment rates.

- **The Continental model.** Hiring and dismissal restrictions are strict, the unemployment insurance system is generous, but ALMPs play a lesser role. This results in limited reallocation of labour resources across the economy and substantial unemployment rates.

The current Lithuanian social model cannot be unequivocally attributed to any of these groups. It is especially difficult to assess restrictions on hiring and dismissal because the provisions of the Labour Code that regulate them are quite often not enforced. The roles of the unemployment insurance system and ALMPs are clearer, but it would still be useful to analyse the indicators that describe the importance of all three elements within the model and compare them to indicators of other EU Member States.

2. The social model that has been applied so far

2.1. Unemployment benefits and ALMPs

The generosity of the social insurance system for unemployment can be described by two indicators: the unemployment benefit amount and its duration. Benefit amounts are calculated based on the percentage of income lost by the employee that is compensated by the unemployment benefit payout. Compared to the old EU Member States, Lithuania’s unemployment benefits are very low and compared to new Member States – benefits are still among the lowest (see Chart A). Much the same can be said of the payment duration, which is one of the shortest in the EU (EC, 2015a). The significance of ALMPs is determined based on spending on ALMPs as a percentage of GDP, and the percentage of the unemployed that are participating in these measures. Spending on ALMPs in Lithuania is the lowest among the old EU Member States, but similar to that of new EU Member States (see Chart B). With respect to the percentage of the unemployed participating in ALMPs, the situation is very similar: among the old Member States only Greece has a lower percen-

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9 The term ‘social model’ is ordinarily used in a much broader sense. It covers many other aspects, e.g., collective labour relations, pension, sickness, maternity and other types of social insurance, health, education and other services.
2.2. Restrictions on dismissals of regular employees

Country by country comparisons of employment and dismissal restrictions are based on employment protection legislation (EPL) indexes published by the OECD. These are calculated based on answers to questions about the regulation of employment and dismissal. The majority of the questions are qualitative, e.g., ‘what are valid cases for dismissing an employee’. Answers are grouped according to the strictness of restrictions, e.g., if the redundancy of a position or an employee’s abilities creates a sufficient legal basis for dismissal, the dismissal of employees is considered to be flexible; if the employer is required to take the employee’s age or tenure into consideration, limitations are considered to be less flexible; if regulations require employers to retrain the employee or transfer them to another position before dismissal, then limitations are considered to be even less flexible, etc. There are two principal EPL indexes: regular employment and temporary employment (the latter consists of employment based on fixed term contracts and employment through temporary work agencies). Different EPL areas are also assessed, e.g., dismissal procedures, length of notice periods, severance pay, fixed term contracts, etc.

Lithuania’s EPL index for regular employment falls close to the average for old EU Member States (see Chart C). In about one half of these countries, restrictions are less strict than in Lithuania. Compared to the average EPL index for new Member States, Lithuania’s EPL index is slightly higher (regulations are somewhat stricter). In five out of eight new EU Member States\(^\text{10}\), regulations are less strict than in Lithuania. Regulations are significantly less strict in Estonia, but noticeably stricter in Latvia.

The EPL index assesses three areas: how difficult it is to fire an employee (legal basis for dismissal, re-employment and compensation in cases of unfair dismissal, etc.), how inconvenient dismissal procedures are (complexity, duration) and the length of the notice period as well as severance pay. These areas explain why Lithuania’s EPL index differs from the group averages mentioned previously.

Even though Lithuania’s EPL index does not differ significantly from the average among old EU Member States, it should be noted that in Lithuania the length of notice periods is much longer and severance payouts are much more generous. The most pronounced differences can be found in the notice periods and severance pay offered to employees with shorter tenure. However, this is offset in the index calculations by much more simple and quick dismissal procedures (see Chart D). For example, when dismissing an employee, the employer is not required to inform or receive the approval of any third parties, e.g., work councils, trade unions, government institutions, etc. These various factors also explain the differences between Lithuania’s EPL index and the average index value among new EU members. However, firing an employee is more difficult than in newcomer States because limitations exist for the dismissal of certain groups, e.g., the disabled, employees raising children, etc. Moreover, dismissal is only allowed if the employee cannot be transferred to another position. In most new Member States, the redundancy of a job position or an employee’s professional skills serve as sufficient legal grounds for the dismissal of an employee.

\(^{10}\) The index is not calculated for Bulgaria, Cyprus, Malta and Romania.
It is worth noting that these assessments are based on the assumption that the legal regulation governing the dismissal of employees is actually enforced. However, information presented by the media and various international institutions points to the reality that in Lithuania these provisions are quite frequently not complied with. For example, in 2010, when the labour market was in poor shape and unemployment reached 17.8 per cent, only 2.1 per cent of all dismissals were initiated by the employer and at no fault of the employee (in such cases the employee should receive severance pay). In later years, this percentage decreased even further and only reached 0.6–0.9 per cent (Verslo Žinios, 2015). It is doubtful that only such a small percentage of employment contracts were terminated at the initiative of the employer. These numbers most likely reflect the often-mentioned practice when dismissed employees leave their job ‘voluntarily’ without receiving any severance pay. This failure to comply fully with the regulations governing dismissal has also been noted by international institutions (OECD, 2016 and EC, 2015b). Thus, the assumption can be made that in Lithuania the dismissal of an employee is not always accompanied by the requisite severance pay. This reduces Lithuania’s EPL index value from 2.23 to approximately 1.73. However, comparing this hypothetically reduced index value with the index values of other countries is not necessarily justified. The level of development in the majority of new EU States is comparable to Lithuania’s, thus some of these countries might be experiencing a similar lack of compliance in terms of dismissal regulations. Of course, this aspect should pose less of an issue in the old EU Member States; therefore, using the recalculated value for comparison in this context would be meaningful. In this case, only two countries – UK and Ireland – would have a lower EPL index value than Lithuania.

It is possible that the dismissal restrictions that are actually applied in Lithuania, as opposed to those established in legislation, are relatively flexible and comparable to the Anglo-Saxon model. A similar conclusion was also made by the IMF (2014). As a matter of fact, different regulations apply to different enterprises: for those who comply with all the provisions regulating dismissal, regulations are moderately strict, for those who do not – regulations are flexible.

2.3. Restrictions on using fixed term employment contracts

Lithuania’s EPL index value for temporary employment is much higher than the average index values of both the new and old EU Member States (see Chart E). In all EU countries, except for France and Luxembourg, restrictions are more flexible than in Lithuania. This pronounced strictness is the result of especially restricted hiring based on fixed term contracts. Limitations on employment through temporary work agencies are more flexible in about half of both new and old EU Member States.

Restrictions on employment based on fixed term contracts are assessed based on three criteria: valid cases for the use of fixed term contracts, maximum number of successive fixed term contracts, and their maximum duration (including successive contracts). These criteria explain why Lithuania’s EPL index value is much higher than the average index value of new or old EU Member States (see Chart F).

The most significant factor in this case is that Lithuanian regulations do not allow employers to enter into fixed term contracts for work that is permanent in nature, except for cases in which a new job position is created (since August of 2015, such exceptions are no longer applied, but this was not taken into account because calculations of the index were based on legislation valid on 1 January 2014). The majority of EU countries either allow such contracts in a greater number of cases, e.g., when an individual is employed for the first time, is a participant of ALMPs, etc., or does not limit such contracts at all. Another reason behind this pronounced difference is that regulations prohibit the extension of fixed term contracts. However, this raises some doubt whether such prohibition exists. In Lithuania, this type of contract can often be extended an unlimited number of times; however, its duration, including these extensions, cannot exceed 5 years.

In light of these circumstances, Lithuania’s EPL index might not completely accurately reflect the strictness of current regulations. It is worth recalculating its value based on two assumptions in relation to fixed term contracts: that fixed term contracts cannot be used for work of a permanent nature, even if a new job position is created; and that such contracts can be extended an unlimited number of times. However, the recalculated value of the index (which falls from 3.21 to 2.96) is still much greater than the average index values of new and old EU States. The correction reveals that employment protection is stricter than in Lithuania not only in France and Luxembourg, but also Spain and Estonia.

Overall in Lithuania, regulations restricting the use of fixed term employment contracts are some of the strictest in the EU. There is no basis for the belief that actually existing restrictions differ from those established in the law. Such contracts are actually used rarely: in 2015, only 2.1 per cent of employees were employed based on fixed term contracts in Lithuania; in the EU, a smaller percentage was only recorded in Romania.

Chart F. Factors contributing to the deviation of Lithuania’s EPL index for temporary employment from the average index value for new and old EU Member States in 2013–2014.
3. What will the new social model change?

The new Labour Code\textsuperscript{11} will restrict less both hiring based on fixed term contracts and dismissal. It will no longer prohibit the use of fixed term contracts for work of a permanent nature. However, such contracts will not be allowed to make up more than 20 per cent of an employer’s employment contracts. The maximum duration of such a contract will also drop from 5 to 2 years. These limitations should help avoid the overly frequent use of fixed term contracts. The new code establishes five new types of employment contract: employment under several employers, job sharing, temporary work, project-based work and apprenticeship. The latter two are quite similar to fixed term contracts, so they will also give the employer more possibilities to hire employees for a set period of time.

Regulation of the dismissal of employees will also be more flexible. The code defines more cases for the legal dismissal of employees, and the costs of dismissing an employee are noticeably reduced. If an employee is dismissed by the initiative of the employer and with no fault of the employee, the employer is required to provide severance pay of 0.5 or 2 months average wage. The previous version of the Labour Code required severance pay of 1 to 6 months average wage. The new code introduces the possibility for the employer to fire an employee on any non-discriminatory grounds, i.e., at the employer’s discretion. In such a case, the employee must receive three days’ notice and be paid severance pay of 6 months average wage.

Finally, the new social model also provides for greater unemployment benefits and easier access to them. The model also entrenches possibilities for increasing ALMP funding; however, whether this funding will be increased remains to be seen.

Conclusion

In the social model applied up to this point, the role of unemployment benefits and ALMPs was insignificant within the framework set up to protect individuals from the consequences of unemployment. A much greater role was played in this respect by restrictions on dismissal and hiring based on fixed term contracts. They were set up to discourage employers from firing greater numbers of employees, and very generous severance payouts were meant to replace an employee’s lost income. A substantial portion of the burden of protecting employees fell onto the employers. However, such a social model did little to protect employees. As mentioned before, the practice of dismissed employees leaving the job ‘voluntarily’ without receiving any severance pay was quite a frequent occurrence. However, not all employers could enjoy this practice – those who complied with all the provisions of the Labour Code that regulating dismissal, paid out some of the most generous severance packages in the EU. The new social model will attempt to place more responsibility for the protection of employees on the unemployment insurance system as well as ALMPs and decrease the significance of regulations governing dismissal and employment.

Sources

\textsuperscript{11} Entered into force on 14 September 2016; its amendments – on 3 November 2016.

\textsuperscript{12} Discriminatory grounds: sex, race, etc.