

II. ARTICLES

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**CHANGES IN THE REAL ESTATE AND LABOUR  
MARKETS DURING THE PROCESS OF LITHUANIA'S  
INTEGRATION INTO THE EUROPEAN UNION**

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No complex assessment of the new possibilities and possible restrictions attached with EU membership was carried out in Lithuania during the pre-accession stage of the EU integration. Today, when the actual integration process is already taking place, it is necessary to provide a balanced evaluation of the situation, that is, to highlight possible strategic attitudes of a small country like Lithuania in the context of EU integration. The paper attempts at reviewing the changes which are currently taking place in Lithuania's real estate and labour markets, listing their main developments and challenges, and defining the prospects in the at least not-too-distant future.

**Keywords:** real estate market, labour market flexibility, labour migration, Lithuania's integration into the EU

**INTRODUCTION**

While preparing for the referendum on the European Union membership in Lithuania, no complex assessment was made of the new possibilities and possible restrictions attached with membership. The EU was promoted by presenting the European living standards, which undisputedly had a strong psychological effect on the voters. The real integration process which Lithuania is going through today urges the performance of as balanced as possible evaluation of the situation. In addition, the likely strategic attitudes of a small country, like Lithuania, should be brought to light in the context of integration.

Changes in the political, social, and economic environment in Lithuania, and membership in the EU created favourable conditions for the

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development of the economy and a decrease in unemployment. However, due to natural demographic conditions and immigration, the number of employed persons in the country will not be increasing over the next few years, because the general number of employable persons in Lithuania fell by more than one per cent (nearly one tenth of employable persons have left the country).

The decreasing unemployment, an accelerating rate of wage growth, the opening up of European Union labour markets, and the optimistic expectations of the consumers towards economic growth had a positive impact on the real estate market. This sector is one of the fastest growing in Lithuania, and such active growth was largely influenced not only by the improved situation in the labour market and better living standards, but also by the implementation of the proper legislation for mortgage loans, which provided possibilities for a larger part of the population to buy a newly built property. A considerable growth in real estate prices over the past years encouraged even more vigorous investment into this sector (both dwelling and commercial property). All these factors promote the creation of new jobs and stimulate employment.

On the other hand, sudden changes in the real estate market (such as the price crisis) could cause a temporary slowdown in the growth of the Lithuanian economy, and have an adverse impact on the labour market, as some people who borrowed money from the bank to buy real property, could be forced to emigrate and seek work abroad in order to repay the loan. The termination of activities by some building and real estate organizations could also lead to an increase in unemployment levels and a fall in GDP.

Taking into account these important issues, it is highly relevant to evaluate both: changes in the labour and the real estate markets, and their impact on the growth of the country's economy in the context of the EU integration.

## **1. THE DEVELOPMENT OF LITHUANIA'S REAL ESTATE MARKET DURING ITS INTEGRATION INTO THE EU**

### **1.1. Impact of the real estate market on economic growth**

The effective use of real property resources is the main advantage of the real estate market that is undergoing its formation phase. Real property related activity accounts for approximately 25-30 per cent of the total economic activity (or GDP) of many western countries. Real estate

constitutes 30-40 per cent of the total state property in the US. The significance of real estate in a developed country's economy is well understood by both the developed and developing countries (*Benefits of Developing...*, 2002). In reality, the companies and persons enjoying property rights have a potential source of wealth. Such property is the capital which grows if developed by the economy. The economic possibility to exploit this unutilized value is the direct function of the efficiency of the real estate market.

On the one hand, the development of the real estate market increases labour mobility inside the country, because people are more willing to move to the regional centres that offer jobs, if they have a possibility to acquire a dwelling. On the other hand, it contributes to reducing the emigration of the qualified specialists who otherwise are looking for employment and a place to live in other countries.

The distribution and redistribution of land and buildings are the main function of the real estate market in developed economies, and the most significant contribution to the creation of economic welfare. The market is the mean which enables to use real estate and ensures its selection according to type, location, management, and utilization conditions in all sectors of the economy. An efficient real estate market has an influence on economic development through economic activity, provision of dwelling, investment, mobilization of property resources, and the interface with the finance sector.

The real estate market is closely interrelated with various other markets including those of finance, construction works, building materials, labour resources, and consumer goods. For example, the growing activity of the real estate market increases the demand for financial resources, construction works, building materials, and labour resources. On the other hand, the development of the real estate market might be influenced by the yield of other financial assets, lower investment risk and the condition of the banking system.

The authors present contradictory opinions: while one opinion holds that the growth of the real estate market stimulates economic development, the other claims that investment into real estate withdraws financial resources from other branches of the economy and consequently leads to an economic downturn (Galiniene, 2004; Galiniene, Marčinskas, 2005). This opinion is supported by the graph showing the cycles of real property market and economic development (Figure 1).

The dynamics of development cycles of the real estate market and economy do not correspond in time. Usually, a decline in the real estate

market is observed prior to the decline of the economy in general. The relationship between the curves in the case of growth is the same. Maksimov gives the following reasons for this mechanism (Maksimov, 1999, p.27-28). The increase and the decrease in monetary value in the financial sector force the consumers to relinquish long-term investment into real estate, which results in reduced demand in the real estate market. The supply of real estate cannot promptly react to the changed conditions, i.e. the supply exceeds the demand for some time, which leads to the decrease in real estate prices and decline in construction volumes, thus the consequences are transferred to other markets. Once at the lowest point, the market “changes over” by changing the technologies or concentrating construction in other regions.

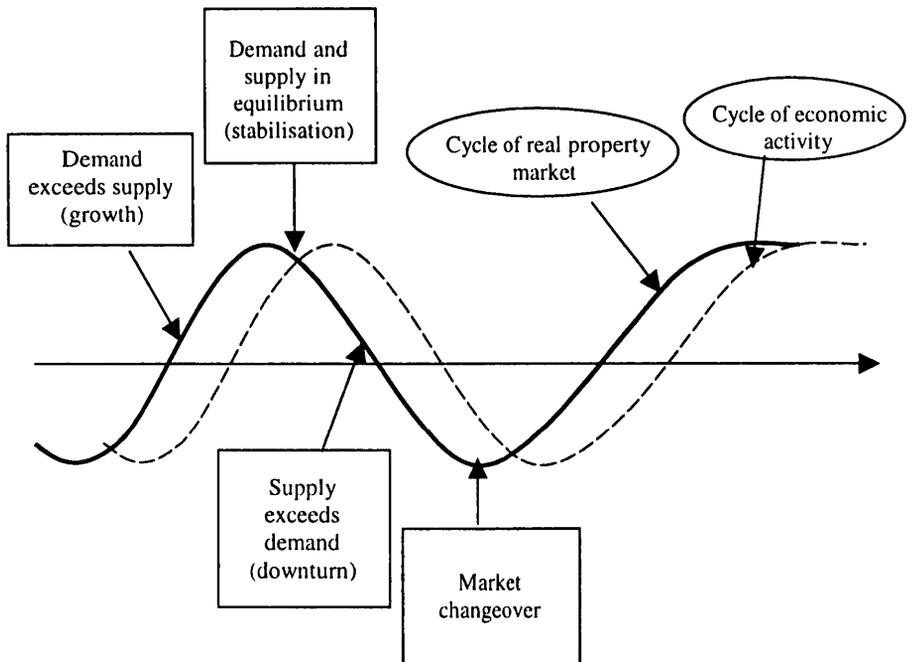


Figure 1. Development cycles of real estate market and economic activity

Source: S. Maksimov, 1999, p.27

Further, the growing money supply in circulation as well as other factors contributes to the increase in demand in the real estate market which leads to market recovery. At this point, the real estate market becomes the key factor which stimulates the growth of economy.

There exists a strong econometric relation between the amount of market-mobilized capital and economic growth. In econometric terms, there is also a good relation between the development of the mortgage market and economic growth. Market-mobilized capital enhances economic growth. The regression analysis of the level of economic growth in respect to market-mobilized capital (own and borrowed) in 40 different countries with different revenues shows that if the market-mobilized capital doubles, the level of economic growth increases by 1.3 per cent (this is a sufficient factor for shortening the time span required to double the GNP from 70 to 30 years (Adlington et al, 2000)).

### **1.2. Changes in the real estate investment patterns in Lithuania**

According to the opinion of many analysts (and this opinion can be supported), the real estate market in Lithuania is going through its growing phase at the moment; however, it already shows the first signs of maturity. Some sectors of the market have already reached the peak; therefore, further development can be expected only in certain segments. Lithuanian towns bear more and more resemblance to European cities as modern skyscrapers tower above their city centres offering a wide range of entertainment, shopping and business facilities, and accommodating the largest international and national companies.

Risks that the first investors faced when entering this market ceased to exist after Lithuania joined the EU and the NATO. Now, the investors accept lower yield rates than before (in the period from 2004 to 2005 the yield rate declined from 11-12 per cent to 10-10.5 per cent).

In the course of market formation, five generations of typical investors can be distinguished:

- local or foreign investors, who search for a good opportunity to make a profit and invest for a term of approximately two years;
- mainly local investors, who renovate already existing buildings and can offer projects of higher quality;
- investors who settle for a longer period of time and are interested in larger objects;
- property funds and wealthy persons, who acquire an object of a certain value, create added value by managing it, and in such a way optimize the investment value;
- companies who purchase cash flows and create added value by means of shares and bonds, i.e. by managing their investment portfolio.

Having passed through the aforementioned stages of market evolution, many countries of Central and Eastern Europe, including Lithuania, now represent the fourth or fifth generation.

A decrease in interest rates, combined with economic growth and high expectations upon accession to the EU, initiated a steady growth in both the commercial and residential real estate sectors.

The forecasted substantial increase in real estate prices in the residential sector has come true. The prices of apartments in the prestigious districts of bigger Lithuanian towns have increased by 30 per cent since May 2004. The price of apartments in newly built houses in residential districts has increased by 30-40 per cent, and that of apartments in older precast block houses has increased by 30-35 per cent. However, such abrupt rise in prices was not conditioned by a sudden improvement in the country's economic condition or an influx of wealthy foreigners but rather, by the wish of citizens to acquire a dwelling before its price had gone up. Such a substantial increase in the numbers of persons wishing to purchase a dwelling was largely influenced by statements based on optimistic future expectations, viz.: "the price of apartments will increase after the EU accession", or "introduction of the euro will dramatically increase the housing prices", as well as favourable borrowing conditions.

The forecasts suggest that the rate of price increase will slow down in the near future and stabilize subsequently. Although the prices of real estate in Vilnius are nearly identical to those in Riga or Tallinn, they are noticeably lower than the real estate prices in better developed countries of Western Europe. According to the survey carried out by the European Council of Real Estate Professions (CEPI), 2004 saw an increase in prices not only in Lithuania and Latvia (a 30 per cent price increase was observed in Riga), but also in other European countries, including Denmark (12.6 per cent), Spain (14 per cent), France (17.8 per cent), and Norway (13 per cent). A decrease in prices was observed only in Germany (-2.2 per cent) and Austria (-2.39 per cent).

### **1.3. Factors influencing the development of the real estate market**

The process of development of the real estate market in Lithuania during EU integration process encounters various barriers that are mostly created by the country's recent historical past and the then predominant planned economy.

These barriers should be clearly distinguished from the obstacles created by a lower level of economic development in comparison to industrial economies. Since all impediments to the development of the real estate market are closely interrelated, it is difficult to dissociate and address a single problem without applying complex solutions covering essential issues.

Since the influence of the real estate market is so significant and full-scale, the mentioned barriers may affect the other economic sectors; while their removal, on the other hand, may produce a positive effect on the whole economy of a country. The barriers may be exposed in various spheres: cultural, political, social and economic, legal, governmental and public administration, financial, banking, and private sector support.

The following four principles are still relevant to Lithuania:

1. Minimum of essential governmental functions. Governmental functions in market regulation should be minimized on the basis of their nature, but not on the discretion of governmental structures to exercise such functions.

2. Costs and benefits. Performance of any function should be economically grounded, i.e. the costs associated with the performance of a function should not exceed the benefit which it provides. The question is how these costs should be financed: by the state budget, i.e. by the taxpayers, or the clients (natural and legal persons)? Whatever the decision is – the system support should be cost-effective, and the service price should be affordable.

3. Civil service. The authorities should clearly understand their mission – to provide services, not to control or manage the market.

4. Possibility of realization. Before making a decision about what system of real estate administration should be created, the state should evaluate all costs and benefits attached to it. The feasibility of creation and implementation of such system should be the essential issue.

## **2. CHANGES IN THE LABOUR MARKET IN THE CONTEXT OF LITHUANIA'S INTEGRATION INTO THE EU**

### **2.1. Trends in Lithuanian labour market flexibility**

The flexibility of the labour market presents an issue of major importance for Lithuania, because flexibility may be needed to offset asymmetric shocks, especially when monetary and fiscal policies are constrained (Boeri, Brueckner, 2001; Chandler et al, 2002; Paas et al, 2003).

The flexibility of the labour market can be examined from three different approaches: macroeconomic perspective, and the viewpoints of an employee and an employer. From the macroeconomic perspective, flexibility enables to effectively utilize and distribute the labour resources, which consequently increases the participation and mobility of labour in the market, reduces unemployment and optimizes the employment structure. From the viewpoint of an employee, a flexible labour market facilitates the search for desirable employment, enables to obtain more information on employment, and reduces mobility expenditures. Finally, market flexibility provides an employer with broader possibilities to adjust personnel numbers, the composition and margins of remuneration (*Lithuania...*, 2002).

In order to describe the changes that occurred in the labour market upon Lithuania's accession to the EU, it is advisable to analyse the flexibility of the labour market in view of the three approaches.

In terms of macroeconomics, the flexibility of the labour market in Lithuania can be characterized by a low level of utilization of labour resources and a broad scope of restructuring. In spite of a substantial economic growth that had been observed since the middle of the nineties (*Economic and Social Development...*, 2005; *Lithuania...*, 2002; *Sectorial Survey...*, 2004), the labour market remained stagnant.

One of the possible reasons accounting for this is the increase of factual remuneration, which outbalanced the increase of work productivity and, therefore, increased the labour costs. The average monthly salary in the period from 1999 to 2003 increased by 7 per cent. However, taking into account a rather high rate of changes in GDP, it could be stated that the increase of average salary was too slow and the majority of the country's population hardly experienced any improvement of living. The impact of this indicator on the labour market is quite contradictory (*Sectorial Survey...*, 2004). On the one hand, the slow increase of average remuneration created favourable conditions for employers to take on more employees, as the increase in labour costs was rather slow. On the other hand, a relatively low remuneration level reflects the low level of workplace quality, in particular, it does not stimulate an increase in employee performance, and eventually creates the risk of employee emigration. These problems became especially urgent after Lithuania joined the EU. The average net monthly salary amounted to 264.3 euro (367.8 euro gross) in 2004.

In addition, there exists a rather big turnover of workplaces. The high level of redistribution of surplus workplaces reflects the intensive restructuring of the companies. However, the negative impact that the

elimination of jobs has upon employment could be lessened if the business environment was more favourable for the creation of new workplaces. The growth of employment in Lithuania would benefit from the high level of the creation of new workplaces, but not from the low level of their elimination. However, a big turnover of jobs increases the gap between the employees who change jobs, and the unemployed (mostly unqualified) who cannot find jobs for a long period of time. The solution of long-term unemployment should not be associated only with the slowdown in the restructuring of workplaces, but also with an increase in labour mobility (in terms of qualification and geography).

From the employee's viewpoint, the flexibility of Lithuania's labour market is somewhat restricted, because the possibilities to easily find a rewarding employment are limited. The risk of losing one's job is quite high, and the unemployment period is usually long, especially for persons of low qualifications or little experience.

Although the level of unemployment has been declining quite fast, the relatively high unemployment is still probably the main social problem and an impediment to the increase in the living standards of the country's population. Approximately one out of ten economically capable residents of Lithuania had the status of an unemployed person in the period from 2002 to 2003. One out of 14 residents from the age of 15 onwards was unemployed in 2003.

Lithuania's accession to the EU has drastically changed the situation in the labour market. According to the data by the Lithuanian Labour Exchange, the level of unemployment at the end of 2004 plummeted to 10.6 per cent, while at the beginning of the same year it constituted 13 per cent. In comparison to April 2004, the number of unemployed persons in April 2005 was lower by 27.3 per cent (42,300). In May, 5.4 per cent of the working age population were jobless, as compared to 7.5 per cent a year ago. The biggest decrease in unemployment was registered among young people aged between 15-24 years, from 26.6 per cent in the second quarter of 2003, down to 21 per cent in the same quarter of 2004. This happened because young people tend to look for legal and illegal work abroad.

Compared to other EU countries, Lithuania demonstrated a rapid decline in unemployment rate. The highest unemployment levels in 2003 were observed in Poland and Slovakia: 18.8 per cent and 18.0 per cent respectively; and the lowest levels of unemployment were registered in Luxembourg, Austria and Ireland: 4.2 per cent, 4.5 per cent, and 4.5 per cent respectively. Unemployment in Lithuania in the same period was equal to that of Spain, and exceeded the 9 per cent unemployment rate of

EU countries by 1.8 percentage points. Further, the biggest decline in unemployment in the period from 2000 to 2004 among all EU countries was observed in Lithuania and amounted to 5.6 percentage points. Such a decrease was influenced by the increasing migration of the population and the improvement in the services by regional labour exchanges, which was conditioned by the implementation of active labour market measures.

The rate of declining unemployment is hindered by changes in taxation policy, which are unfavourable to business and employment, a tightening of labour relations regulation, an increase in the mandatory minimum wage, and the high unemployment of unqualified workers, and a shortage of qualified specialists. The latter factors are particularly significant to the most important issues of the Lithuanian labour market, that is the high level of structural unemployment and the large number of people who have been unemployed for more than two years. The predominant level of unemployment in Lithuania at the moment is close to the so-called natural level of unemployment. As the practice of the developed economies shows, structural unemployment is not such a negative phenomenon, because it reflects the technical and technological progress of the economy, such as the advance of new products or modern technologies, which causes changes in the demand of the labour force. Lithuania so far lacks this: neither education nor vocational training systems are perfect; and it is obvious that cooperation between education and business increases slowly (*Sectorial Survey...*, 2004).

From the viewpoint of an employer, labour market flexibility (although the market is not rigid) could be increased in many cases. First, consideration is given to the restrictions that the employers face when attempting to adjust the number of employees and remuneration in line with the changing demand (*Lithuania...*, 2002). In Lithuania the restrictions on the adjustment of labour force are mostly conditioned by the employee protection laws. Due to these laws, employers incur costs associated with hiring and dismissal of the personnel. In addition, restrictions on remuneration occur due to the established minimum wage and other minimum amounts provided by the laws. This index is relatively high in Lithuania and constitutes approximately 40 per cent of the average wage. This could have a negative influence on employment as the demand for employees of low qualifications is decreasing because the companies are reluctant to create low-output jobs.

## 2.2. Migration as the important aspect of the labour market flexibility

One more important aspect of the labour market flexibility is labour mobility. According to specialist opinions, the decreasing unemployment and increasing shortage of the labour force are associated with both the high rate of industrial growth (over 10 per cent), and the growing migration of the population (*Economic and Social Development...*, 2005; *European Integration...*, 2001).

From the economic point of view, migration is the response to economic possibilities of better living conditions that are subject to the situation in the labour market (i.e. differences in salaries). Migration opens up possibilities to a receiving country (to increase the labour force), and to a country of origin (to decrease the unemployment rate). However, at the same time the country of origin suffers a decrease in the labour force, which in turn exposes the problems of social relief and economic development.

The migration process is conditioned by two groups of factors: pushing and pulling. Pushing factors are: demographic factors (decrease in population of the working age and thus declining social system); economic factors (differences in salaries; weak social system, increase in unemployment, low income per capita). Pulling factors are: demographic policy (e.g. strive to attract more young labour force); geographical locality, cultural compatibility; higher income; better welfare system and infrastructure.

It would be difficult to identify and name the causes for the emigration of Lithuanians by focusing exclusively on the analysis of the Lithuanian case in the context of international migration, and by ignoring the fact that the causes of international migration are also rooted in global macroeconomic processes. Lithuanians are allured to foreign countries because their country of origin is small and not as powerful as the countries who receive migrants; moreover, it can not offer certain jobs, for example, for highly qualified computer specialists. Although the receiving countries benefit from the selective immigrant policy implemented by big countries, Lithuania suffers negative consequences as the part of the population who departs the country weakens the formation of the middle layer of society. Tolerating illegal work in the black or grey markets is another strategy used by foreign countries to attract immigrants.

Two contrary trends became evident: a decrease in internal migration turnover (territorial mobility of population inside the country) and an increase in unregistered (or unofficial) emigration. The decrease in internal

migration turnover shows that the territorial mobility of the Lithuanian population was conditioned by the tendencies of the same nature. The number of arriving and departing persons in 1990-2001 decreased approximately threefold (the indicators in 2001 constituted 32 per cent and 37 per cent of the level of 1990 respectively). Despite this, 2002 saw a slight change in the situation: for the first time after the restoration of independence, the turnover of the internal mobility of Lithuanian population began to show a slight upward trend (due to the number of arriving and departing persons). In 2001-2003 the total number of departing persons in the country increased from 44,700 to 46,100, and the number of arriving persons – from 42,200 to 61,200.

The level of illegal emigration was quite substantial even before the EU accession. About 200 000 persons seeking jobs abroad left Lithuania in January-May 2004. Unofficial data has it that currently 320,000 – 360,000 Lithuanians are working in the European Union (in Great Britain, Ireland, Spain, Germany and the Scandinavian countries), while the total population of the country slightly exceeds 3.4 million.

These processes resulted in a shortage of labour force in Lithuania. Despite a rather high level of total unemployment, Lithuania has been facing a more and more pressing structural shortage of employees in a number of professions. Since autumn 2005, the deficit of highly qualified, semi-qualified and unskilled labour force has been especially obvious in building, light industry, chemical industry and services sectors. The problem of “brain drain”, i.e. the emigration of highly qualified professionals including doctors, IT specialists, and scientists in biotechnologies, electronics and physics, is becoming more acute.

On the other hand, the number of persons arriving to Lithuania from Belarus, Ukraine, Moldova, Russia and Asia increases. 800 foreigners were issued work permits in Lithuania in 2003; and in 2004 the quota of employment of foreigners rose to 1,000 persons. Therefore, to solve the problem of shortage of the labour force, Lithuania should follow the pattern set by EU member countries, i.e. to increase the quotas, to open the labour market and to accept those foreign employees who are satisfied with the local remuneration levels.

Considering the development of the Lithuanian labour market in perspective, it should be noted that the forecasts provided by different institutions, that the situation in the labour market would improve upon the EU accession proved true. Taking into account recent economic growth, the average annual number of employed persons in the country should grow by

approximately 55,000 in 2005 compared to 2002. The number of employed persons in yet further prospect (comparing average numbers of 2009 and 2005) is expected to increase at a faster rate (approximately by 30,000 per year). Due to the economic recovery, the average annual unemployment rate in the period from 2002 to 2009 will fall (to 6.5 per cent). Later unemployment will decrease at a slower rate. Assuming that the level of unemployment at the end of the forecasted period (till 2009) will nearly reach the margin of natural unemployment, it can be stated that this forecasted scenario would essentially correspond to the idea of full employment actively promoted in the EU employment strategy (Pocius, Zabulytė, 2004). The maintenance of a certain degree of tension in the labour market when the unemployment level does not exceed 5 per cent could be useful, as persons who are registered with the labour exchange are motivated to work. On the other hand, transition economies experienced obvious employment problems when economic reforms in fact were carried out at the expense of the downturn in the labour market.

## CONCLUSIONS

1. The real estate market in Lithuania is going through its growing phase at the moment and already shows the first signs of maturity. Lithuania, like other countries of Central and Eastern Europe, having passed through the first stages of market evolution, now represents the fourth or fifth generation marked by the appearance of investors who settle for longer periods of time, and are interested in larger objects, as well as property funds and companies who create added value by managing their investment portfolio.

2. The following four principles are still relevant to Lithuania: the obligatory governmental functions should be minimized; the costs associated with the performance of the function should not exceed the benefit which it provides; the authorities should provide services, not control or manage the market; the appropriate real estate administration system should be put in place.

3. The changes that occurred in the labour market upon Lithuania's accession to the EU have been described in the context of the labour market flexibility in terms of macroeconomics, from both an employee's and an employer's viewpoints:

- In terms of macroeconomics, flexibility of the labour market in Lithuania can be characterized by the low level of utilization of labour

resources, a broad scope of restructuring and the remaining labour market stagnation.

- From the employee's viewpoint, flexibility of the Lithuanian labour market is somewhat restricted, because the possibilities to easily find rewarding employment are limited. The risk of losing one's job is quite high, and the unemployment period is usually long.

- From the viewpoint of an employer, labour market flexibility (although the market is not rigid) could be increased by reducing the restrictions that the employers face when attempting to align the numbers of employees and the margin of remuneration with the changing demand.

4. Two contrary trends became evident in Lithuania: a decrease in the migration turnover (territorial mobility of population inside the country) and an increase in the unregistered (or unofficial) emigration. These processes resulted in a shortage of labour force; in particular the deficit of highly qualified, semi-qualified and unskilled labour force had been obvious. The problem of a "brain drain", i.e. emigration of highly qualified professionals is becoming more acute.

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