

Ágota Scharle

## **Integrated employment and rehabilitation services: evidence from Hungary**

The Hungarian labour market has never fully recovered from the transitional recession. The employment rate of the working age population is the lowest in the EU and has been stagnant for the past ten years. The underlying reasons can be found mostly in the poor employment chances of three, largely overlapping population groups: uneducated, disabled and older workers. Of the three groups, the labour market access of disabled workers has been the least studied in Hungary. This paper contributes to filling this gap in the literature by briefly reviewing current trends in the labour market and in rehabilitation policy and summarising the main results of a recent survey on the efficiency of rehabilitation schemes. The main conclusion is that a redesigned system of subsidies could significantly improve the employment prospects of disabled people in Hungary.

### *Background*

Prior to 1989, labour force participation and employment were rather high in Hungary. During the transition, employment dropped from over 71% in 1990 to below 55% by 1993 and has never since exceeded 58%. The adjustment of labour supply to the decline in labour demand caused by the transitional shock followed two channels. Beside the rise in unemployment, labour force participation fell significantly during the 1990s. Most people leaving the labour market became eligible to some social provision, such as old age pension, disability pension, or maternity allowance. By 1995, the share of benefit recipients among the working age population reached 31% and was close to 30% even in 2005 (Duman and Scharle 2011).

In 2008, almost 14% of the active age population (aged 15-64) suffered from some sickness or disability which reduced their capacity to work.<sup>1</sup> Around 75% of this group received some welfare provision and only 23% worked. However, about 9% (150 thousand people) indicated that they would like to work but could not find a job, while the current system of wage subsidies only provides subsidised employment to 30-40 thousand disabled workers.

*Table 1. Economic activity of able-bodied and disabled working age people in Hungary*

	Population aged 15-64		Long term ill or disabled	
	2002	2008	2002	2008
Working age, thousands	6850.0	6789.8	748.2	938.0
Of which: employed	3847.2	3850.7	85.9	215.5
unemployed	229.2	340.0	9.9	42.5
Economically active, %	59.5	61.7	12.8	27.5
Employed, %	56.2	56.7	11.5	23.0
Unemployed, %	5.6	8.1	10.3	16.5
Inactive but would like to work, % of working age	6.6	4.8	14.4	9.4

Source: Own calculations based on the Labour Force Survey data of the Central Statistical Office, 2002, 2nd quarter and 2008, 4<sup>th</sup> quarter.

As table 1 above shows, there has been some increase in the employment of the disabled population recently. However, the 2008 level is still very low, in Western and Eastern European comparison as well. According to comparable Eurostat statistics for the

<sup>1</sup> Own calculations based on the Labour Force Survey data of the Central Statistical Office, 2008 4<sup>th</sup> quarter, which included supplementary questions on disability.

year 2002, disabled employment ranged between 29 % (Spain) and 74 % (Sweden), and in the new member states the Hungarian figure was the lowest (at 12 % in 2002) and the Czech figure was the highest (48%).

### *Policies affecting the employment of disabled people*

Apart from the decline in labour demand, the employment prospects of disabled people have been largely determined by two main types of welfare provision: pensions and rehabilitation subsidies.

#### *a) Disability pensions*

Disability pensions<sup>2</sup> had been available since before the second world war, while disability benefit<sup>3</sup> in its current form was introduced in 1983. The eligibility rules of both schemes remained unchanged during the transition, but – as in many other transition economies – the evaluation of claims was rather generous (Allison and Ringold 1996). As Vanhuyse (2004) argues, the lenient pension policy introduced in order to forestall social discontent or resistance at the time of the regime change was a rational political decision and social insurance institutions were therefore willing to co-operate in granting early pensions to workers facing insecure prospects of employment. As a result, the number of people under retirement age in receipt of disability pensions rose from 233,000 in 1990 to 352,000 by 1996 and doubled by 2003.

It must be noted that this process had started well before the regime change. However, the upsurge in disability pension claims starting in the mid-1960s was accompanied by a clear and substantial decline in the general health of the population. The situation was different in the late 1980s, when the previous declining trend in health indicators seemed to be reversing. Based on multivariate analysis of county level panel data, Scharle (2008) showed that the rising incidence of disability pension receipt during the economic transition was largely a consequence of labour market tensions.

As public spending on pensions steadily increased while revenues remained low due to the low employment rate, governments began to acknowledge the need for reform. Between 1998 and 2009, several attempts were made to curb disability pension claims by tightening both the rules and the practice of evaluation committees, and wage subsidies and training programmes were gradually extended to cover disabled persons, low qualified workers and older workers. The boldest of such measures was the introduction of a rehabilitation allowance in 2008. This was granted to new claimants of the disability pension or disability benefit whose work capacity could be partially or fully rehabilitated (as assessed by a committee of health and employment experts). Recipients of the allowance must cooperate with the PES and participate in trainings or other rehabilitation services as required by the PES. There has been a noticeable drop in disability pension claims in recent years but there has been a parallel improvement in

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<sup>2</sup> Act II of 1975, currently in effect, states that people with a 67% reduction in their work capacity are entitled to disability pension provided that no improvement is expected in their condition within a year. The entitlement ceases if the claimant recovers and/or his or her income approaches the level at which it was before the onset of disability. The amount of pension is determined with reference to previous income, similarly to old age pension: at 25 years of service, it equals the amount of old age pension, with additional compensation for a total impairment of health. The entitlement to disability pension does not cease when retirement age is reached, the claimant continues to receive the disability pension.

<sup>3</sup> Various benefits (labelled disability benefits in table 3) are paid to claimants not satisfying either the service years or the loss of work capacity condition of the disability pension. The benefit is flat rate if service years are insufficient and wage related if the claimant has sufficient work history but only between 40-67 % loss in their work capacity.

the educational composition of the cohorts nearing pensionable age. The impacts of these two factors have not been clearly separated yet.

*b) Rehabilitation subsidies*

Assistance in the labour market rehabilitation of unemployed people with reduced work capacity is mostly provided by the public employment services network in the form of advice and subsidies to employers and services to disabled job seekers.

Historically, state subsidies predominantly went to sheltered workshops and factories. Several expert reviews had uncovered inefficiencies in the subsidy system and an empirical study in 2004 found that the rehabilitation activities of firms providing sheltered employment tended to be firm-specific and training or services facilitating the return to the open labour market were rare (*Krolify, 2004*).

In the past five years, the system of rehabilitation subsidies was gradually revised partly to increase the social integration of disabled people and partly to curb growing public expenditures and improve efficiency. Since 2005, only accredited employers equipped to provide employment rehabilitation qualify for wage subsidies. However, public funding has not been directly linked to rehabilitation outcomes so there is practically no incentive for firms to assist the transition of their workers to the regular labour market. In practice, though formally meeting the accreditation criteria, most firms still do not provide services that would support the transfer to unsubsidised jobs. Also, though accreditation rules require that the share of disabled workers should be at least 40-50% in sheltered workshops, the share of disabled employees is typically much higher, between 60 to 100%. Thus, despite the clear intention of the government to increase labour market integration, a large share of state subsidies still goes to sustaining segregated employment.

The government decree of August 2007 on disability policy<sup>4</sup> set the objective of developing rehabilitation services to facilitate open labour market participation by the end of 2009 and preparing job centre staff for performing associated tasks by the end of 2010. Service provision has developed in two strands. There is a non-governmental strand, in which NGOs (some set up in the early 1990s) offer services to clients on first come first served basis, using their own, rather varied methods. These NGOs received dedicated government funding first in pilot projects and later in annually launched competitive grant schemes. There is a public strand developed in the past five years mainly on the basis of EU funds. This is operated by local job centres, which provide some services by their own staff and some services by contracting non-profit organisations (that may be NGOs in the first strand). In both strands there is considerable variation in the quality and efficiency of rehabilitation services and in availability across regions (*Gere, 2000; OSI, 2005; FRSZ, 2006*). The development of NGO services is severely limited by the lack of stable government funding arrangements which increases financial insecurity (*FRSZ, 2006*).

*The policy challenge*

The above review of the labour market situation and relevant policies leads to fairly clear policy conclusions. The task appears to be twofold: on the one hand, the current system needs to be restructured in order to reduce incentives to leave the labour market permanently and on the other hand, effective and efficient policies must be developed to assist those with low chances of finding secure jobs in the regular labour market. A

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<sup>4</sup> Government Decree 1062 of 2007 (August 7) on the preparations for the implementation of the new National Disability Programme for the period 2007-2010.

number of Western European governments have faced a similar problem and starting from the 1990s, some have implemented policy measures which proved to be viable (OECD 2008). British, Danish, Dutch and Swedish experiences suggest that the solution has three key components. The first two are aimed at reducing incentives: tighter regulations on eligibility conditions and a reduction in benefit amounts. The third component offers an alternative: effective active labour market policies or social services which enhance work capacity and employment prospects. Focusing on the third component, the next section reports the results of a recent survey that attempted to assess the performance of existing NGO rehabilitation services and compare it to the reemployment chances for workers in subsidised sheltered jobs.

### *The efficiency of rehabilitation services – survey results*

In 2010, the Budapest Institute conducted a three-phase survey of rehabilitation services provided by sheltered workshops and NGOs. In the first phase, administrative data on a sample of employees and clients were collected from all the main employers and service providers receiving a rehabilitation subsidy in 2009 (table 2). In the second phase, a smaller sample of high performing organisations was selected and a sample of their employees/clients were invited to fill in a questionnaire. The third phase examined the three best performing service providers to identify the organisational and other features that make their services successful. The summary below focuses mostly on the results of the first phase, which measured the reemployment chances of employees and clients in subsidised and regular jobs, controlling for age, work capacity, education and local unemployment.

*Table 2 Response rate and sample size*

	total stock (number of organisations)	responded	response rate %	Supplied individual level data*	employees/clients	
					Sample of organisations	Sample with individual data
Sheltered workshops**	21	17	81	15	13710	13462
Accredited employers**	48	23	48	22	4895	4508
NGO service providers	37	29	78	11	4479	1148
Total	106	69	65	48	23084	19118

\* some respondents only provided data on their organisation (legal status, size, type of services offered, etc.) and some provided individual level data on their employees or clients but with missing variables so that they had to be dropped from the individual level analysis. \*\* Sheltered workshops are also accredited but are treated as a separate group as they qualify for higher subsidies. Accredited employers in the survey only included the so called 'priority' group entitled for the highest level of subsidies. The two groups are legally distinct but otherwise rather similar – their differential treatment by the government mainly reflects the historical development of the subsidy system.

The administrative data collected in the first phase of the survey included demographic information, wage, working hours, the date of entering the organisation (as an employee in the case of sheltered workshops or as a client in the case of NGOs) and the date and direction of exit from the organisation. Using this data, the probability of exit to an unsubsidised job (or to any job) is estimated, given the type of organisation, tenure, age, work capacity, and education of the individual and the local unemployment rate.

This estimate was then used to predict hypothetical employment probabilities for each observed individual, using the true values of demographic variables but varying the dummies indicating the type of organisation. The resulting average probabilities are presented in Table 3.

*Table 3 Average observed and predicted reemployment outcome by type of organisation*

(1) type of organisation	(2) observed	(3) N	(4) observed	(5) predicted (sheltered)	(6) predicted (NGO)	(7) N
	entered between aug 2008 and jan 2010 (total sample)		entered between aug 2008 and jan 2010 (regression sample)*			
Sheltered workshops**	3.1	2064	0.6	0.6	21.2	1236
Accredited employers**	15.5	862	5.7	0.5	18.9	280
NGO service providers	38.6	516	38.9	1.4	38.9	499
Total	11.5	3442	10.8	0.8	25.3	2015

\* By design, the regression sample only included individuals with no missing explanatory variables.

\*\* See note for Table 2 above.

The above results clearly show that employment in sheltered workshops or accredited firms contributes very little to the chances of a disabled worker to transfer to the regular labour market. Even if considering exits to any job (rather than only unsubsidised jobs), less than 1% of workers would exit to other employment within 6-23 months of entering the firm. The reemployment chance of NGO clients is 30 to 50 times higher compared to disabled workers in a sheltered workshop, controlling for individual characteristics and the local labour market.<sup>5</sup> The best service providers can place 33-49 % of their clients in unsubsidised jobs in the regular labour market.

### *Policy implications*

The full social integration of disabled people clearly requires further reform: a gradual reduction of employment subsidies, an expansion of rehabilitation services and better-designed incentives for all actors. The system of subsidies should make all actors interested in placing disabled workers in integrated jobs in the regular labour market. On the basis of a detailed review of the current Hungarian subsidy system and international best practice, incentives could be strengthened by:

- a gradual shift in quality assurance towards performance measurement and performance based finance and away from administrative requirements and accreditation certificates;
- an increase in the stability of financing rehabilitation schemes;
- an increase in state expenditures on effective rehabilitation services at the expense of wage subsidies for accredited employers;
- requiring all accredited employers and service providers receiving a rehabilitation subsidy to place a certain proportion (adjusted to work capacity) of their disabled workers or clients in the regular labour market;
- expanding the capacity of rehabilitation service providers and ensuring access to services across the country.

<sup>5</sup> The gap is larger if exits to unsubsidised jobs are considered only, but may be biased by missing information: most firms had no information on whether the new job of their former employee was subsidised.

- establishing a monitoring system that provides information on the labour market performance of disabled workers employed in subsidised jobs or receiving NGO services.

Based on the estimates presented above, a reallocation of a fifth of current wage subsidies for disabled workers to NGO-provided rehabilitation services would increase the disabled employment rate by over 2 %points and would become self-financing within four years through the social security contributions and income tax paid by disabled workers placed in regular jobs.

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