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Los costes sociales de la transformación en europa central y oriental

RESUMEN:
La clave del proceso de transformación fue el cambio de estatus de estas economías en el seno de la economía mundial, pasando de ser la "periferia desarrollada" de un centro subdesarrollado (la Unión Soviética) a ser la "periferia subdesarrollada" de un centro desarrollado (la Unión Europea). Este cambio de estatus se basó en la repentina ruptura de los antiguos vínculos económicos (COMECON) y la brusca apertura de los mercados de estos países a la competencia del mercado mundial. La responsabilidad de los países occidentales en este proceso es extremadamente alta.

Este artículo analiza los costes sociales de la transformación de los países de Europa Central y Oriental, resaltando la existencia de diferencias significativas entre unos y otros países y el hecho de que dichos costes sólo tenderán a incrementarse con el paso del tiempo.

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Social costs of the transformation in Central-eastern Europe

SUMMARY:

The key procedure was a dramatic position change of these economies within the world economy - from the previous position of a "developed periphery" of an underdeveloped centre (SU) in to the position of an "underdeveloped periphery of a developed centre (EU). This position change was based on the sudden collapse of former economic links (CMEA) and the dramatic exposure of the markets of these countries to open competition on the world market. The responsibility of the West in the above mentioned process is extremely high.

This paper aims to take a closer look at the social costs of the transformation in CEE countries. We have to recognise at the beginning that social costs in Eastern European countries may differ greatly. It is an important factor that slow or mistaken transformation does not diminish social costs; on the other hand, these costs will only increase with the time lost.

Key words: Transition Economies, Central-Eastern Europe, PECO'S, Labour Reforms, Wage costs, Social Policies, Welfare State, Economic Development.

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SOCIAL COSTS OF THE TRANSFORMATION IN CENTRAL-EASTERN EUROPE

Dr Béla Galgóczi*

1. Introduction

The most painful thing in the transformation was not "the transformation from a planned economy into a market economy" itself, (as it is so often mentioned) but much more, the way as it has happened.

The key procedure was a dramatic position change of these economies within the world economy - from the previous position of a "developed periphery" of an underdeveloped centre (SU) in to the position of an "underdeveloped periphery of a developed centre (EU). This position change was based on the sudden collapse of former economic links (CMEA) and the dramatic exposure of the markets of these countries to open competition on the world market. This has brought the industries of these countries into bankruptcy (see the perfect illustrative example of Eastern Germany). The major problem was that the present oligopolistic structure of the world economy (dominated by powerful multinationals) raises very high obstacles for newcomers to enter the market or even to keep their own domestic markets.

The necessary transformation processes also took place under similar conditions in most CEE countries:

- protected markets controlled by powerful multinationals (difficult market access, high entry costs);
- general lack of capital concerning both domestic and foreign capital;
- no clear property rights;
- missing infrastructure and poor institutional and legal framework;
- economy under high domestic and foreign debt;
- exhausted population, expecting the quick improvement of its living standards from the transformation.

In order to adopt to the new rules of the game, these countries started with an enormous "modernisation deficit". To finance this, would have been possible through outside support (see Eastern Germany or a "Marshall Plan"), or through internal sources. These were however nonexistant, the solution thus was:

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- to give free way to foreign capital, which makes these economies wholly dependant and/or
- to raise some of the needed financial resources within the domestic economy, ie. to redistribute resources from the social sphere (welfare institutions, education, health care) into modernization and restructuring of the economy (e.g. the Hungarian stabilisation measures of 1995).

This latter means, the initial "moderisation deficit" is being converted into "social deficit".

The responsibility of the West in the above mentioned process is extremely high, as

- no outside help was given to CEE countries,
- the transformation of most CEE countries went through via capital extraction through the continuous repayment of their previous debts to Western countries (even the rescheduling or cancelling of debts was denied) /the aggregated forein debt of CEE counties was not much more then one year financial transfer of Western Germany to Eastern Germany).

It can be concluded that the West was not very generous, but rather shortsighted, although it realised enormous profits from the quick opening of CEE markets.

In the next sections, we will take a closer look at the social costs of the transformation in CEE countries. We have to recognise at the beginning that social costs in Eastern European countries may differ greatly. It is an important factor that slow or mistaken transformation does not diminish social costs; on the other hand, these costs will only increase with the time lost.

2. Macroeconomic environment, social impacts

It is well known that the transformation towards market economy had severe social impacts in in all transformation economies. With the sudden collapse of previous economic structures, GDP decreased by 20-50% (varying country by country) in the first two-three years of transformation, which was accompanied by the drastic fall of real wages and by the increase of poverty.

Table 1. Level of GDP on real terms in 2000, compared to the level of 1990 (=100,0)

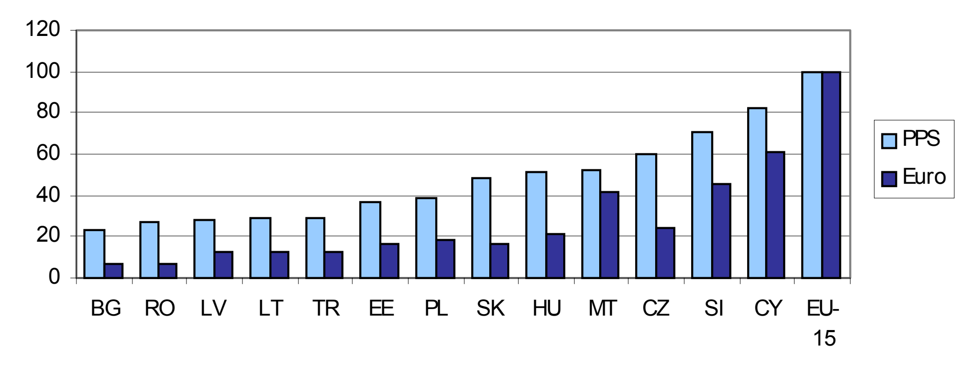
CZ	*SK*	*HU*	*Pl*	*Sl*	*RO*	*BG*	*EE*	*LV*	*LT*

100,3	109,1	109,7	144,0	121,6	84,4	80,1	97,5	62,0	70,1

Source: WIIW database 2001, European Training Foundation 1999, own calculations

By the year 2000, only four countries managed to surpass the level of GDP in 1990. Poland takes the lead by 44% growth, followed by Slovenia with a GDP growth of almost 22%. Slovakia and Hungary show a GDP growth of 10%, while the Czech Republic has just reached the GDP level of 1990 in 2000. Latvia has the poorest record with having in 2000 just 60% of its GDP level a decade earlier. Lithuania, Bulgaria and Romania still have a way to go in reaching their ten years ago GDP.
The next graph shows the GDP/capita level of candidate countries in relation to EU average for the year 2000.

Graph 1. GDP per capita in levels, Current euro vs. PPS



Source: Eurostat 2001

The difference between the GDP/capita of CEE candidate countries compared to EU average shows an enormous gap, if we use exchange rate parities. In this case the differences between individual CEE countries is also great. If we regard data at purchasing power parities, the gap appears much smaller, although individual countries still range between 20 and 70% of the EU average.
Hyperinflation was induced in several countries, which had a primary impact on peaople living on wages. Parallelly, there was an enormous differentiation taking place in the society, as rich got richer and poor got poorer. The level of real incomes went back to that of the early 80-s and the number of people living on existence minimum reached around 30% of the population.

Even though economic growth started in most CEE countries from the mid nineties, the growing imbalances of the economy were threatening in many CEE countries. The severe cuts in public spending, which became necessary time to time in individual countries and the fundamental structural change of the economy has created the basis of sustainable growth in the more successsful CEE countries, although these had tremendous negative social impacts.

We could say the economic deficits of the economy were converted into social deficit.

CEE countries have managed to transform their economies in ten years, as a result of which they are now functioning market economies with the share of the private sector around 80%, the share of foreign capital in producing GDP at 20-40%, over 80% of trade being conducted with EU countries. The most successful transformation countries show a 5-10% yearly growth in productivity and 3-6% yearly growth in GDP by which they are the fastes growing region in Europe nowadays.

The other side of the coin shows: a dramatic drop in employment; a polarised society; continuing low wages; fewer employee rights and less workplace safety; a bankrupt health care system; and a public education system, which is living up its resources.

To calculate the cost of the transformation, there is one example where these costs appear explicitly: the case of Eastern Germany. As is known, around one-half of the roughly 1000bn Euro total transfer from West Germany was in the form of social transfers.

The internal consumption of the Eastern *länder* of Germany was twice as high as their GDP (in the case of CEE countries, when state household deficit reached 5% of GDP, alarm bells started ringing in the IMF). However, it would be a gross over-simplification to say that the social cost of the transformation can be set as DM 1000bn in ten years for a country of 17 million people, but this horrifying figure still tells us something. Even if we take into account that the Eastern German transformation was the least effective and the most expensive one in the region, with incredibly high re-sources squandered, and, if we take notice of its special political motifs, it is still a signal as to the magnitude that the costs of transformation could reach.

3. Unemployment

Unemployment grew drastically from practically zero in 1990 to an average of around 12-13% by 2000.

Table 2. Unemployment rate (ILO methodology) as % of labour force

	1996	*1997*	*1998*	*1999*	*2000*
BG	13,7	15,0	16,0	17,0	16,4
CZ	3,9	4,8	6,5	6,7	8,8
HU	9,9	8,7	7,8	7,0	6,4
Pl	12,3	11,2	10,6	13,9	16,1
RO	6,7	6,0	6,3	6,8	7,1
SK	11,3	11,6	12,5	16,2	18,6
SL	7,3	7,4	7,9	7,6	7,0
EE	10,0	9,7	9,9	12,3	13,7
LV	18,3	14,4	13,8	14,5	14,6
LT	16,4	14,1	13,3	14,1	16,0

Source: European Commission 2001

Only Hungary, Slovenia and surprisingly Romania show low and stable unemployment figures under the EU average (8,2% in the year of 2000). The still favourable unemployment rates of the Czech Republic show a continuous deterioration. The rest of the countries, including Bulgaria, Poland, Slovakia and the three Baltic states have high and persistent unemployment around and above the 15% mark. It also gives reason for concern that this latter group of countries shows an increasing trend of unemployment.

As regards the nature and characteristics of unemployment in CEE countries, one could say that this kind of unemployment is of a recessionary origin, but it is structural in its main respects. At best, we could call it transformational unemployment.

Most of these countries have a rather rigid workplace structure for decades. This, together with the rigid skill and education structure, meant that the adaptability of the system is still very low. Schooling and the vocational training system are very bureaucratic and are not oriented towards practical application. The very low level of territorial mobility is determined by the poor condition of the housing infrastructure and the conditions of transportation, which make territorial mobility extremely difficult.

There is no substantial labour migration inside of these countries, although there are extreme differences in labour demand between different parts of the countries.

Overdemand for labour disappeared once the economy moved into deep recession and the transition to a market system accelerated. Decline in investment and domestic demand, cuts in spending in the public sector, and privatisation have all contributed to a falling demand for labour.

The level of employment fell drastically in the course of the transformation, it made up around 12 million for the 10 candidate countries in the period of 1990-2000. The total number of registered unemployed for the 10 CEE candidate adds up to around 4-5 million people. The rest of underemployment is a result of several factors, although around half of the people, who are out of employment, but do not count to be unemployed, have become economically inactive, although they are of an active age. The number of students rose also, such as the number of pensioners. As a result of the above trends, the ratio between earners and non-earners changed in a very unfavourable way by the end of the nineties.

There are, unfortunately, very high regional disparities of unemployment in all countries, which seem to be being preserved even under conditions of rapid economic growth. This means that the situation in some structurally backward regions can be dramatic.

In Hungary for example, where the national average of unemployment is rather low (5,7% in 2002), figures in Eastern Hungary can well exceed 20%, while in certain Western Hungarian regions there is labour shortage. In Poland, which has a general unemployment level of around 18%, in some Eastern Polish Voyvodships local unemployment rates can apprach the level of 40%.

It is also a great problem thet even under the improving general labour market conditions, long-term unemployment remaines further on very high. This shows that the losers in the transformation are struggling on the periphery of society without future prospects.

Welfare policy

Speaking about welfare policy in transformation countries, we should be cautious not to fall into the trap of symplifications. The social system was often called an early born welfare state, arguing that the overgenerous and inefficient social system inherited from state-socialism can not be financed by an economy under transformation. The previous socialist type welfare system was in fact overdimensionated, where the state took over several functions of the family and enterprises, thus compensating low wages (e.g. free health care system, generous and untargeted child care support, kindergardens, etc.). There existed a totally untransparent and otherwise unjust housing system, where the previously nationalised private flats and houses were rented out at symbolic prices to families, mostly of course those, who belonged to the nomenclatura. Anyway housing costs were not included in wages, as they are still not, although the housing policy of the state gas changed fundamentally.

On the other hand the state and local governments were totally unprepared for tackling the problem of unemployment and poverty, for these were acknowledged as nonexistant. The evolution of social systems show the pattern of taking back from the overgenerous welfare services of previous socialist character (as free health care, family support), while introducing the frameworks of Western style unemployment and poverty policy. This has been more or less accomplished by 1992 in most of the CEE countries, while the former is still under way in form of the austerity programs.

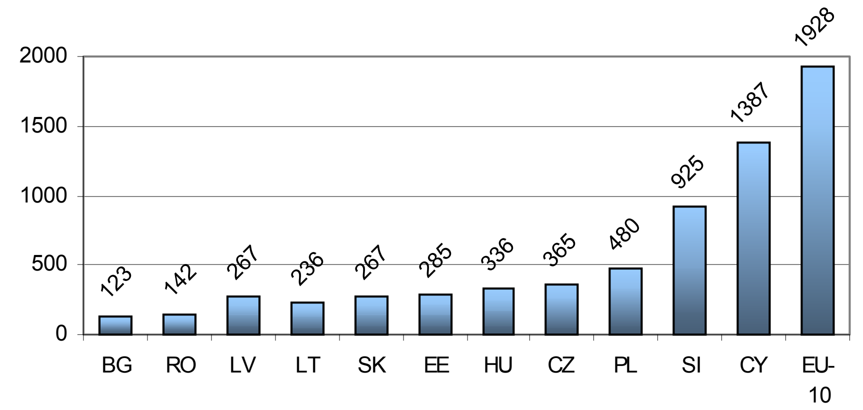
4. Wages and Wage Differentiation

4.1. Wage developments

When examining wage development in candidate countries in the past decade, we have to be aware of several difficulties. As price and cost structures in transition economies still show substantial differences to developed market economies, direct comparison of wage levels at nominal terms expressed in Euro can be misleading. Unequal and disproportional transformation developments in individual countries can lead to substantial shifts in certain economic indicators year by year. The impact of inflation and changing currency regimes, such as stabilisation measures can produce sudden changes from one year to an other.

The second graph shows the levels of average gross wages in manufacturing industry in candidate countries in Euro. For comparison, the industrial average for 10 EU countries stands here, as well.

Graph 2. Average monthly gross wages in candidate countries in 2000 (Euro)



Source: Eurostat, Statistical Yearbook on candidate countries, WIIW, 2001 ; and Earnings in industry and services in the EU, 2000

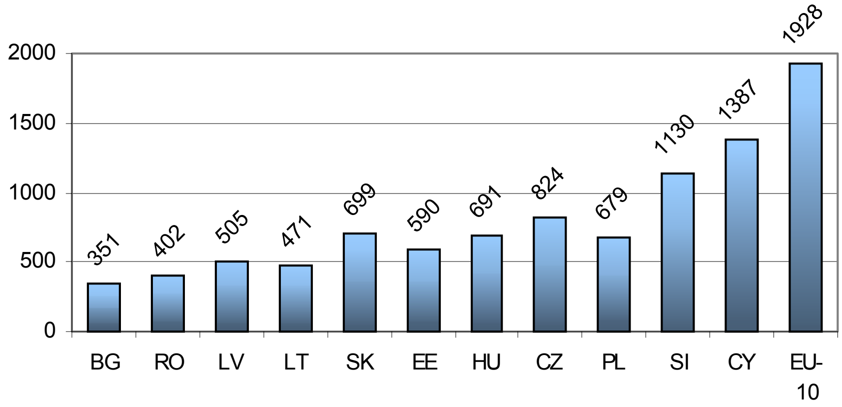
Note:EU-10 covers DK, DE, ES, FR, IRL, NL, AU, PT, FI, UK in 1998

Monthly average gross nominal wages in total economy throughout candidate countries range from 123 Euro in Bulgaria and Romania to 480 Euro in Poland, if we exclude two countries with much higher wage levels: 925 Euro in Slovenia (data 2000) and 1387 Euro in Cyprus (data 1999). Monthly average gross nominal wage throughout the European Union ranges from 606 Euro in Portugal to 2997 Euro in Denmark (data 1998).

For example, whereas EU average wage stands at 1928 Euro monthly, candidate countries (without Cyprus) have an average of 345 Euro.

This all means that if we want to examine the background of wage developments, we need a deeper analysis of economic processes. Anyway, nominal figures seem to be rather shocking, although wage levels at purchasing power parity show a somewhat less dramatic view.

Graph 3. Average monthly gross industrial wages in Euro at PPP in candidate countries in 1999



Source: Eurostat 2001, Competitiveness of Industry in CEE countries WIIW 2001.

Now taking the average of the industrial wages at PPP of the ten Eastern European candidate countries, we receive 634 Euro, which compared to the 1928 Euro for the 10 EU countries gives a more balanced distribution. This only indicates that the gap in living conditions is not that great, as seen from nominal data and shows that the danger of social dumping is not as threatening, as one would think for the first sight. It is also interesting to see that the proportions among candidate countries also shows a substantial shift. The case of Poland is quite apparent, which ranked so high on the previous graph, but here shows a value quite near to the average of candidate countries. There are two factors in the background. Industrial wages on the one hand are relatively lower in Poland than wages for the whole economy and price levels are also nearer to the European average, leading to relatively lower values at PPP. The strong appreciation of the Zloty plays a role, as well.

The most important lesson of the above data is, that the development of real wages in the period between 1992 and 2000 is lagging substantially behind labour productivity developments and in most countries also behind GDP growth. Exceptions are Lithuania, Latvia and Estonia, where wages have increased close to productivity and much more than GDP in the 8 year period. In these latter countries wage increases in the eight year period seem to be beyond economic performance. Lithuania is the only CEE country, where wage increases substantially surpassed both productivity and GDP growth. The trends in all three Baltic countries show that wages grew faster than productivity in the first half of the period and the tendency was reversed only in the last couple of years.

It is the Czech Republic, Slovenia, Slovakia and Poland, where wage increases follow productivity developments to some extent and correspond or even override GDP growth. In the Czech Republic productivity on the 8 year period grew by 10 % faster than wages. Beside Baltic states, the Czech republic is the only candidate country, where wages grew substantially more, than GDP.

The productivity/wage discrepancy in the case of Poland was 34%, but wage increases were still somewhat higher than GDP growth. The situation in Slovenia is similar to that of Poland. These two countries seem to manage a rather proportional development of wages and economic performance.

This can by no means said about Romania, Bulgaria and especially about Hungary. In these countries wages lagging much behind economic performance. In Romania the relative level of productivity is twice as high than that of wages regarding the period of 1992-2000. Wage dynamics are lagging behind GDP developments, as well. The situation is most dramatic in Bulgaria, as wages are a mere 60% of the 1992 level, while the level of GDP almost reaches the 1992 level and productivity exceeds the value of 1992 by almost 50%.

Wages are the most depressed compared to economic performance in Hungary however, as the level of productivity is almost 2,5 fold higher, than that of wages, if the level of 1992 is taken as basis. Wages are also roughly 20% behind GDP growth.

It must be emphasised that the situation is most concerning in Romania and Bulgaria, as there not only the relative position of wages is very low, but wages are very low on absolute levels, as well. In Hungary the very depressed level of wages according to economic performance still means a wage level, which belongs to the upper range of candidate countries. In Hungary a very strong development of productivity stands against a very moderate (almost stagnating) wage increase. In Romania and Bulgaria however a productivity growth close to the average of CEE countries faces a substantial drop of real wages. The Romanian situation is peculiar, since productivity shows a very uneven development. It is not shown in the above time series because of reasons of comparability, but the years 1990-1992 brought a collapse of productivity in Romania by a decrease of some 60% at the time when wages did not drop that dramatically. So if we take a ten-year period of observation, productivity almost stagnated in Romania, while wages dropped by around 25%, which gives a more balanced picture.

4.2. Wage Differentiation

As concerning the differentiation of the wages, since late 1980's we could identify the following tendency: while the wages of the top management got a real boost in the second half of this decade to reach the present relatively high level of about ten times that of the skilled workers. The white collar professionals did gain similar wage increase in the past two years.

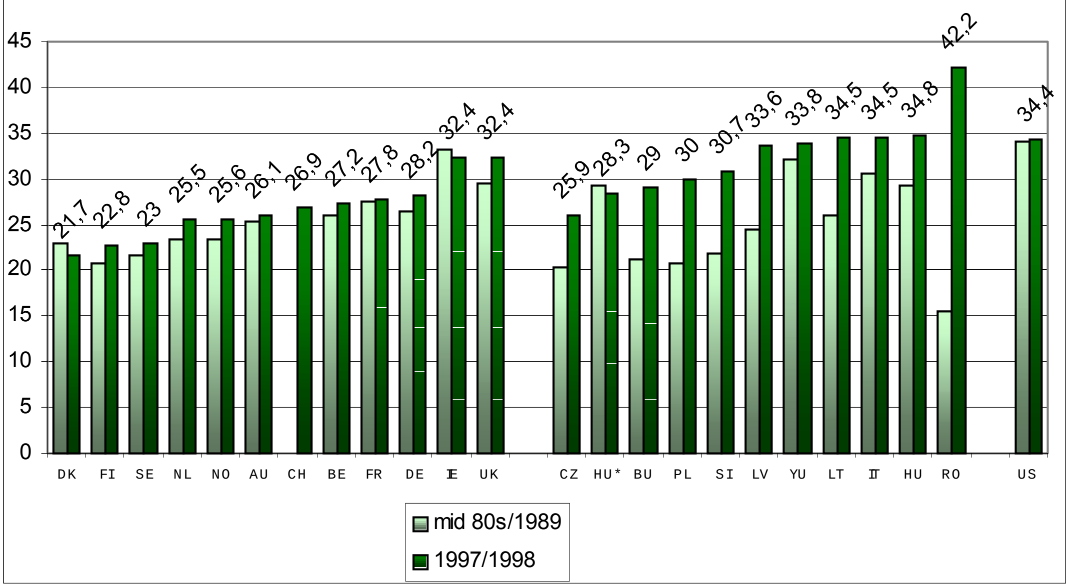
As we have seen above. the general trend of wage-development was a moderate increase, but the inequalities among the various professional groups were growing; for instance the engineers have nowadays too, lower wages compared to the wages of lawyers and economists.

The structure of the wages did change dramatically following the collapse of the socialist-system in the direction: from the equality wage system into the direction of more hierarchical one. The income differentials - which according to official statistics were very narrow /3-4/ during the period of state-socialism) have widened considerably /to around 10/. On the other hand, a large portion of the population has fallen below the poverty line.

The Gini Coefficient measures the degree of inequality in income distribution between top and bottom deciles of income. A low coefficient means that the society is rather egalitarian and a high coefficient that inequality is rather important. The US coefficient is at 34.4 whereas European countries are rather more egalitarian with figures between 21.7 and 28.2 (if we exclude Italy and Anglo-Saxon countries).

This means that the European Social Model can be identified as a society where the dispersion of income is rather more limited than in the USA for example. However, between the mid-80's and the late-90's, income inequality, measured by the Gini Coefficient increased in 9 EU countries according to OECD statistics.

Graph 4. Gini coefficients measuring distribution of income



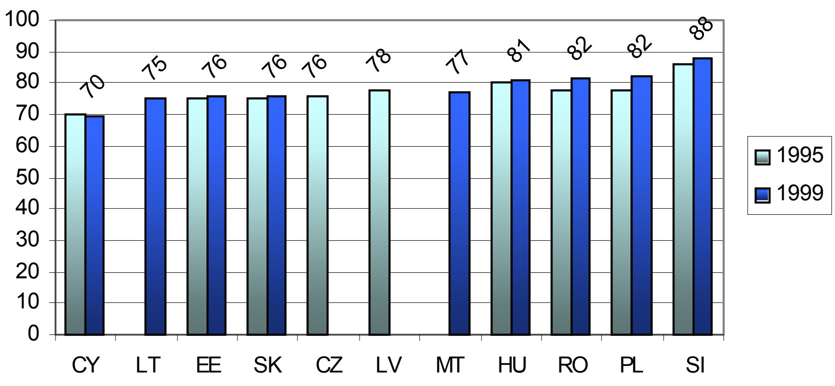
Sources: OECD countries: OECD, 2000; CEECs: UN Monee Database, 1998.
HU*: OECD source, HU: UN source.

In the case of candidate countries, it is important to notice that Gini coefficient are higher than at European average, and closer to the more inegalitarian countries (USA and the Anglo-Saxon countries) with data comprised between 30 and 42, except the case of the Czech Republic where the coefficient is comparable to European standards (25.9).

Moreover, the situation in candidate countries worsened between the mid 80's and the end of the nineties as all Gini coefficient increased. Particularly, most important rises in inequality were observed in Romania, Lithuania, Latvia, Slovenia, Poland and Bulgaria.

4.3. Gender pay gap

Graph 5. Gender Pay Gap in Candidate Countries



Source: Eurostat, Statistics in Focus, theme 3, 5/2001

The difference in average earnings between men and women in the candidate countries seems to be similar to that in EU member states, although the data are not directly comparable according to Eurostat.

Data ranges from 70% in Cyprus to more than 90% in Slovenia, whereas in the EU data ranges from 71% (Ireland) to 88% (Denmark), which are quite comparable results to those of the candidate countries.

In the future, it should be important that figures for the candidate countries and for EU member states should be comparable, and particularly avoid the importance of difference in the composition of job content between men and women, as previously mentioned by Eurostat.

According to the Commission, "a strong initiative is required to reduce gender disparities in both the public and private sectors, including reviewing constraints on labour market choices for women and men, reviewing job classification and increasing awareness-raising and transparency on pay gaps".

4.4. Minimum wage

Minimum wage in CEE candidate countries ranges from 26% to 50% of the average wage.

In Hungary, the minimum wage made up 37,3% of the average wage in 1990, then this ratio sank to 26,5% by 2000. In 2001 the government rose the minimum wage within its own authority by 77%, thus its ratio jumped to 44%, then by a consecutive rise in 2002 by 25% it reached almost 50% of the average wage.

In Romania, the ratio between minimum and average wages at the beginning of 90's was rather high (60%), which then declined to around 39% by 1998. The evolution of minimum salary has constantly and permanently declined, reaching 26.5% of its real 1989 value by 1998.

Minimum wages are not covering subsistance levels in most CEE countries, as a result employees receiving minimum wages are automatically pushed into poverty.

In Latvia for example where the situation is rather worrying, the minimum wage has fluctuated between 42% and 52% of the subsistence minimum in the latest years, which means that one can not make a living from the minimum wage.

5. Living standards, poverty

With the increasing burdens of the tranformation social tensions are growing parallelly. The decreasing patience of the population is also due to the fact that living standard decrease was seen as a consequence of market reforms for a substantial segment of the population.

Poverty is also growing. Taking the example of Hungary, which otherwise shows a sound development during the transformation process, official statistics show that the number of people living under the officially calculated (on basis of a socially still acceptable shopping basket) existence minimum made up one tenth of the population in 1968. On basis of ILO conform calculations this share of the population was 8% in 1989, which doubled until 1992, than rose to 20% in 1994 and did not change since then significantly, although the economy showed substantial growth year by year.

In other CEE countries, where structural problems of the economy have not been addressed properly and economic growth is not sustainable, the level of poverty can reach 40% of the population. In countries like Bulgaria, Romania and Latvia poverty is still a mass phenomenon.

Poverty in absolute terms (incomes compared to subsistance minimum) is rather high, as we see, but poverty in relative terms is even higher. This we can see, if we compare average incomes of diffrent social strata to the national average of incomes. If the ratio is under 50% of the national average, we regard the person as poor. Using this calculation, poverty in Central Eastern Europe is even higher, being close to 50% in countries with the highest social problrms.

The loseres of the transformation make up two-third of the society in these countries and real winners are just those whole belong to the priviledged upper tenth of the society.

6. Shrinking public spending

A further factor of the social costs of the transformation is the decrease of the real value of public spending. Health care and public education are the most obvious losers in the transformation process in most CEE countries. Resources have been continuously extracted from these spheres and there has been no systematic reform or transformation. Taking Hungary as example, statistical data show that health care expenditures have shrunk almost by one-half during the decade of the transformation.

The share of health care expenditures in GDP have fallen from 9,8% in 1990 to 5,6% by 1998.

This is a clear demonstration of the principle termed earlier "converting the modernisation deficit into a social deficit". In the case of health care, this has gone so far that the performance of even the basic functions can be endangered.

The situation of public education is somewhat different. It has also been a victim of the transformation, but it is still performing its main functions, mostly due to its fine traditions. In Hungary, education spending within the GDP fell from 5,8% in 1990 to 4,6% in 1999. It is, however, short-term thinking to seek savings in education when everyone is speaking about the knowledge-based society. Several CEE countries, including Hungary still have quite favourable competitive advantages in this sphere, but these are rapidly deteriorating.

7. Conclusions

Summing up the above, the costs of the fundamental restructuring of the economy have been covered mostly by internal resources. Foreign direct investment has played an outstanding role in the actual transformation of industry in most CEE countries (especially in Hungary, the Czech Republic and Poland), but the total amount of FDI (around. $100bn for the 10 CEE countries by 2000) is still a small part of total restructuring costs. As a result, resources have been extracted, basically from population consumption and public spending, within which social protection, education and health care have been the greatest victims. This is why wages in most CEE countries are not only lagging behind the EU average, but also behind the economic performance of individual countries.

It can be expected however that in those countries, where transformation was successful and on basis of the new economic structure economic growth proves to be sustainable, social sacrifices are going to have a result and the society can be compensated in the future from the economic wealth created. As the most important question of the present and future is, how this painfully created wealth will be distributed, social justice will be more important, than ever. This needs strong interest representation structures, above all strong and genuine trade unions in a framework of well functioning social dialogue.

In those countries however, where on contrary to the huge sicial sacrifices, results do not appear in the near future in form of a competitive economy, severe further sacrifices are needed. It is a great question, how this should be financed and if the social patience of the society will hold as long. In this regard Romania, Bulgaria one or two of the Baltic states are in danger.