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Labour Market and Social Policy Implications of Structural  
Change in Central and Eastern Europe

RESTRUCTURING IN EASTERN AND CENTRAL EUROPE:  
LABOUR MARKET AND SOCIAL POLICY CONSENSUS ISSUES

GEORG FISCHER AND GUY STANDING

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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RESTRUCTURING IN EASTERN AND CENTRAL EUROPE:  
LABOUR MARKET AND SOCIAL POLICY ISSUES

by

Georg Fischer and Guy Standing

{ Note: This is a background paper intended to help orient discussion in }  
{ the various sessions of the conference; its sections are presented to }  
{ correspond to the order of the sessions. }

I. Introduction

1. Since the exhilarating days of 1989 and 1990, a more sombre mood of consolidation has spread across the Central and Eastern European region, as the enormity of the structural challenge has had to be tackled by a new generation of political leaders and policy makers. Recent events in the Soviet Union and have rekindled hopes for rapid structural change there; yet with the new uncertainties there will surely be a prolonged period before welfare and incomes dramatically improve.

2. With the slow emergence of new institutions and independent organisations of employers and workers, this learning process has had to confront the need to compress into as short a time as possible a vast array of policy changes that took the western industrialised countries four decades or more to develop. But, whereas in the first flush of the transition it was understandable that in some countries policy makers were inclined to do little more than copy systems and laws from specific west European and North American countries, it would be understandable if there were a growing desire to adopt policy reforms more in tune with their own cultures and social structures. No country has an ideal set of laws and social institutions that could be applied to any other. This process of adopting-and-adapting raises exciting challenges for the national and international communities of policy makers.

3. It is common to characterise the transition in terms of a "big bang" approach versus "gradualism". No doubt such a characterisation was always simplistic, yet as far as the subject matter of this conference is concerned,

it might be useful to depict two polar tendencies in competition, from which a wide range of compromise structures could emerge. The underlying debate is between the "decentralised market" and the "regulated market" approaches. The exact role of the State continues to be at the heart of the policy debate. It is surely not good enough to talk of a "market economy"; the issue is what type of market, presuming that everybody in the policy mainstream recognises the virtue of market mechanisms. But by what type of institutions and regulations will labour market mechanisms be mediated? All western industrialised countries have institutional, legislative and legal forms of regulation. These include provisions for collective bargaining, and legislation on labour contracts, working time, occupational health and social security.

4. This dilemma can be seen in the context of, for example, the United Nations' Universal Declaration of Human Rights and the ILO's Philadelphia Declaration of 1944, in which it is stated unequivocally, "Labour is not a commodity". It is intriguing that these were established at a time in the 40s when many western countries were in a somewhat analogous phase of rekindling and strengthening democracy. Such principles imply that protective regulations and institutional safeguards should modify pure market forces, limiting labour market insecurities and promoting a spirit of social consensus and negotiations, rather than unbridled reliance on pure market forces. At the same time, the regulatory frameworks and the institutional structures will have to be flexible and promote economic growth, productivity and international competitiveness. This tension has preoccupied labour analysts in the industrialised market economies over the past decade and is now at the heart of the pro-market reforms in central and eastern Europe. This is the background against which debates over labour market and social policy can be interpreted.

5. The following sections are intended to identify the main issues that seem to be the most important in the spheres of labour market, industrial relations and social policy in the near future. Any such exercise risks the twin threat of appearing like little more than a "shopping list" and of superficiality coupled with excessive generalisation. We hope it will help structure discussion, nevertheless. It will be apparent that some of the views are tentative, others rather bold in the light of the available evidence. The paper focuses on the major issues in the restructuring period, rather than on longer-term reforms and the type of labour market and social structure beyond it.

## II. Recent Labour Market Developments in Central and Eastern Europe

6. In 1990-91, the central and east European economies were hit by a cruel combination of economic factors that have made structural adjustment much harder to achieve. The enormous declines in GDP in 1990 and 1991 have to be seen in the context of the collapse of trade between the countries themselves, the inflationary and recessionary impact of energy price rises due to the Gulf war and the adverse effects of the recession in the industrialised market economies. The reform policies, particularly those concerned with economic

stabilisation, have at most merely compounded the slump. At the end of the 1980s, GDP per capita in eastern and central Europe overall was probably no more than one-eighth of the average in the rest of Europe. Yet in 1990 real GDP probably fell by over 7 per cent, and in 1991 it will probably fall by well over 10 per cent.<sup>F</sup>

•According to the Vienna Institute for Comparative Studies, industrial output in eastern Europe was 13 per cent lower at the end of the first quarter of 1991 than in the corresponding period in 1990. More worrying still, investment fell by about 20 per cent.

<sup>F</sup> In Bulgaria, it is expected to fall by as much as 20 per cent, and in the USSR the fall could be even higher. In no country in the region is GDP in real terms expected to rise in 1991.

7. These stark realities would have caused very severe labour market problems in any country, whatever the structural adjustment strategy. Yet a fact to bear in mind for this conference is that, despite the enormous declines in aggregate economic output, the overall employment decline has been relatively modest. Although there would also have been a lag in the fall in employment, had such declines in national income occurred in industrialised market economies, the cut-back in jobs and the rise in unemployment would have long since raised spectres of the Great Depression. So far, that has not happened in eastern and central Europe. However, with the gathering pace of privatisation and the decline of the famous "soft budget" constraint, there will be a spate of redundancies from the large State enterprises in all the countries of the region. Unless labour shedding occurs on a vast scale, productivity levels will remain disappointingly low, economic growth will be curtailed and the growth of new industries oriented to consumer goods and services will be unduly constrained. In 1990-91, the rise in unemployment has come mainly from a combination of a slow decline in employment and the influx of new labour force entrants. In 1991-92, dis-employment will be the growing factor.

8. Since the late 1980s, structural changes in Central and Eastern European economies have taken several complementary forms, each beginning to accelerate in 1991. The State sector, although still the overriding source of production, income and employment, has shrunk, while the "private" economy has been growing. Privatisation has come more as a result of internal restructuring of industrial enterprises and the emergence of small-scale enterprises, cooperatives (in some countries) or joint-ventures much more than by explicit privatisation of State enterprises through direct legislation. The latter form is accelerating, as evidenced by recent legislation in Romania, for instance, but as of mid-1991 the shift from State to private sector production and employment had come primarily from new sources of jobs outside the stagnant or sharply declining State sectors. And the employment cuts in the latter had greatly outweighed the growth of the former.

9. Privatisation has also taken the form of conversion of State enterprises into joint ventures with foreign firms, which has set up an intriguing form of pluralism of competing employment practices and industrial relations at the enterprise level. It has also taken the form of a growth of small-scale firms, most in the retail trade sector. The biggest question has been: What to do with the large State enterprises that dominated the industrial landscape of Central and Eastern Europe during the past forty years? Clearly, alternative approaches are being pursued in the different countries of the region. For instance, in Hungary it seems likely that many of these will be transferred into joint ventures with foreign capital; in Czechoslovakia and Poland it is more likely that ownership rights will to a considerable extent be distributed

to the population at large through ESOPS (Employee Share Ownership Plans), voucher schemes and other forms of employees' capital. It is not for this conference to make any judgement on the respective merits of the alternative forms of privatisation, but it is important to consider whether the choice will have different labour market implications, or imply the need for distinctive labour and social policies.

10. Other aspects of the restructuring will also shape labour market developments. There will be a long process of labour mobility out of agriculture, which has been a labour reservoir for years absorbing much larger proportions of the labour force than is typical of market industrialised countries. No doubt, governments will be pleased if the labour outflow is slowed in the immediate future, but it may actually accelerate. There has also been a start to the considerable shiftx needed from heavy industries -- "material production" -- to consumer goods and services. And there has been the start of a shift within manufacturing away from industries oriented to the military-industrial complex and towards high-technology, light industry.

11. The difficulty is that so far new investment in the potential growth sectors in most of the countries has been sluggish, as has the adoption of more up-to-date technology and production structures. Many of the new jobs will probably be in new small-scale firms and self-employment, as has been the case in Hungary, perhaps the country most advanced in its restructuring. Although incomes and wages may be relatively high in the new small-scale concerns compared with the old State sector, working in them as wage labour or in own-account employment will mostly be precarious, posing further problems for labour and social policy makers. Some jobs in small-scale businesses will offer very good incomes and benefits, but most will not.

12. There is one issue that is endemic, although it is by no means unique to the region. In all of the countries, much of the real economic activity has taken place outside the "formal" sphere. "Black" or "second" economy work has long complemented that taking place in state enterprises, and while in some countries there has been a legitimisation of many of those activities with the growing pluralism, in others there are strong signs that it has grown dramatically. Although in the following, little reference is made to this phenomenon, it does have implications for the applicability of certain types of labour market and social protection policy. And it is, of course, somewhat related to the first major issue that needs to be addressed.

#### a. Unemployment

13. Given the structural changes, the major labour market development of the past year has been the growth of unemployment. Almost certainly, the situation will become much worse before it begins to improve. As papers for this conference show, so far levels of unemployment have been fairly low by the standards of Western Europe in the 1980s and 1990s, but it is the rate of increase that is alarming. All forecasts agree that most of the six economies will experience double-digit rates of unemployment in 1992, and considerably more than 10 per cent in areas affected by industrial restructuring, for which there are already reports of up to 40 per cent unemployment rates. In eastern Germany, it is forecast that by the end of 1991 the unemployment rate will be

14 per cent, while a further 15 per cent of the labour force will be on short-time. In both the CSFR and Poland, the overall rate is forecast to rise to over 10 per cent by the end of 1991. In the Soviet Union, official fears of up to 30 million unemployed in 1992 represent both a daunting prospect and an indication of the sense of uncertainty among Government officials coming to grips with new realities.

14. Responding to unemployment will be a high priority in 1992. Perhaps the key issues are: Will the period of high unemployment be a short, transitional one or will it last many years? Can the latter possibility be prevented? And if the period is lengthy, what will be the likely labour market and social effects? So far, there is no reason to suppose that the economic restructuring will be marked by a short period of high unemployment. It is much more likely that very high levels -- probably over 15 per cent -- will continue for a long time. If one recalls the economic restructuring in some West European economies where labour market mechanisms have been relatively well developed, the fact that they have had double digit unemployment rates for five-to-ten years must be very worrying for policy makers facing a period of major restructuring without well-established labour market mechanisms to facilitate the necessary labour mobility and employment regeneration.

15. In tracking what is happening to unemployment, it must be stressed that the statistical information available is very patchy. A major reason is that in the old "full employment" system, unemployment was scarcely recognised as a legitimate activity, so that there was little attempt to measure its level or incidence. Moreover, networks of employment exchanges did not exist, so that job-seekers could not easily "register" as such. In 1990-91, statistical offices throughout eastern and central Europe have been coming to terms with conceptualising and measuring unemployment, and sample surveys should become a valuable means of generating labour market information needed for formulating policies for dealing with unemployment as it arises. Besides chronicling the immediate labour market outcomes of the restructuring process, such data will be essential for monitoring and evaluating the direct and indirect effects of new forms of labour market policies, which will be vital if those policies are to be efficient. It is to be hoped that the conference will make some specific recommendations on this practical matter.

#### b. Labour market-related poverty

16. The fears associated with the rising unemployment would be lessened if there seemed a reasonable prospect that those on the margins of the labour market were not going to be in severe financial hardship. And there is the rub. There is strong reason for believing that the extent of poverty in many parts of the region has grown to alarmingly high levels. For instance, the number of households in poverty has risen very sharply in Bulgaria, Poland, Romania and the CSFR, with the real extent probably being much higher than implied by the official statistics, a point made by Alena Nesporova with respect to the CSFR. In Bulgaria, it is estimated that by early 1991 over 70 per cent of all households had incomes below the official social minimum, up from 41 per cent two years earlier. In Poland, over 40 per cent of all households were classified as living in poverty, again up sharply from two

years earlier. These figures may be approximations, but they are bleak as well as more akin to developing country statistics than to market industrialised countries.

17. Whatever the criteria for measuring poverty, it is the rate of increase and the lack of effective forms of social protection in the new labour market circumstances that are most alarming. An issue for this conference is the possibility that the incidence of poverty has become much more related to labour market status and experience. Many of those suffering precipitous declines in living standards have been those cut off from the labour force, such as pensioners, but many others seem to have been impoverished as a result of their position in the labour force, in some cases because of their precarious employment, in some cases because minimum wages have not been applied or because enterprises have been unable to pay even the minimum wages, as in Bulgaria, where the real level of the minimum wage was halved in the year ending in April 1991.

18. As the background papers indicate, there is much to be learned about the links between labour market developments and poverty and inequalities. It is essential to identify those links if effective labour market and social policies are to be formulated.

#### c. Regional imbalances

19. Another labour market aspect of the transition process is that regional imbalances are intensifying, particularly with the decline in heavy industries and the accelerating process of industrial conversion. Once again, there are analogies with what happened in parts of western Europe and north America in the early 1980s. As in those regions, where such industries as coal mining, steel production, shipbuilding and certain "smokestack" industries went into sharp decline, there can be a cumulative deterioration in the local economy and labour market. Thus, the economic decline of some east European industrial regions may be compounded by the emigration of many young, relatively qualified workers, leaving the regions even less attractive for investors and thus intensifying their stagnation. This has already characterised the east German economy. But in some countries, distress migration may only take on major proportions in 1992, when the shrinking of major smokestack industries and the release of currently subsidised workers become substantial.

20. An additional phenomenon is that as employment falls in the industrial zones it may be the outlying rural areas that experience the rise in unemployment, since workers previously commuting will stay in their residential rural areas, where agricultural jobs are unlikely to grow.

#### d. Labour market segmentation: The issue of marginalisation

21. As unemployment rises and economic pluralism spreads, forms of labour market stratification and segmentation could become acute. In other words, specific groups could face labour market marginalisation, pushed into low-income, precarious jobs, or out of the labour force altogether. This has been



a perennial problem of open labour markets in all market economies, and in many parts of Eastern Europe the fear is that ethnic minorities and non-local residents in areas hit by restructuring could face severe difficulties, particularly if there is a persistent resurgence of nationalistic forces. For instance, the unemployment rate of Gypsies in Slovakia apparently reached 27 per cent in May 1991, probably four times the rate for other groups in the population.

22. As far as labour market segmentation is concerned, two issues stand out. What forms of discrimination and segmentation have been developing or are likely to develop? In any market economy, employers use rules to sort out their recruitment, training, promotion and retrenchment practices and preferences. This invariably results in differential opportunities and forms of labour market disadvantage.

23. In the eastern and central European economies, there seems to be a lot of anecdotal evidence of deteriorating experience of minorities, but there is a need for much more detailed data to enable policy makers to monitor developments. That should help in resolving the issue of identifying appropriate mechanisms for limiting or reversing practices that are leading to the labour segmentation and the marginalisation of the particular groups. The market industrialised countries have tried a wide range of approaches, including anti-discrimination legislation, positive incentives to hire specific groups, selective wage subsidies, targeted training programmes and so on. No single approach presents a panacea, but the immediate challenge in Eastern Europe is to identify those measures that have the best chance of preventing rigid social differentiation. It cannot be presumed that left to itself, the labour market will produce a socially integrated labour force.

24. Which groups, besides ethnic minorities, are most vulnerable to marginalisation? First, although their position in market industrialised economies may have improved in recent years, women workers internationally still face difficulties. In eastern and central Europe, under the old centralised system, women workers were relatively integrated into the labour force, having high labour force participation rates by international standards, even if relative opportunities for occupational mobility may have been far from equitable and much concern existed about women's onerous "double day" work, since full-time wage employment had to be combined with domestic work. The fear now is that women will lose as labour force participants by being converted into "secondary workers", suffering disproportionately from high rates of dis-employment and unemployment, being pushed out of the labour force or having their wages and benefits lowered relative to men. The background papers for this conference assess the available evidence on these trends, and highlight the need for much more information on what seems to have been a deteriorating situation.

25. As was the case in western Europe in the 1980s, another group particularly hard hit by the restructuring and rising unemployment consists of older workers, those in their fifties and sixties. The old pattern was for large numbers of "pensioner workers" to be employed, to compensate for low pensions. In recent months, in most of the countries, this has given way to displacement of such workers and more consideration of early retirement

schemes. Perhaps the main labour market problem is that productive older workers may be pushed to the margins of the labour force due to discrimination in hiring and firing, for which there is no justification on labour efficiency grounds. But one way or another, older workers may find it hard to remain in the economic mainstream or avoid severe declines in living standards in the transition period. That raises delicate policy concerns.

26. The third group to be the subject of concern is youth. There is a growing threat of high youth unemployment as opportunities for labour force entry dry up. Because those entering the labour force must provide the skills and aptitudes needed for the economic regeneration, it is worrying that a vast number of teenagers could drift into a debilitating period of long-term unemployment that could make it hard for them to acquire the skills and attitudes that will be essential for making the transition process a success. It is not surprising that special consideration has been given to youths in the development of labour market policies, just as youths received the overwhelming bulk of resources devoted by West European countries to labour market policies for dealing with the mass unemployment that emerged with the structural crises of the early 1980s.

27. Finally, a labour force trend of immediate concern to policy makers is the growth or threat of mass labour migration. Data on this are notoriously incomplete. But what is clear is that with rising unemployment and worsening poverty, many workers will move out of old industrial areas, just as millions have been trying to cross into western Europe, which will further intensify social tensions and labour market difficulties. This conference is not a forum for discussion of labour migration per se. It is worth recalling that migration was the subject matter of a number of technical and ministerial conferences in the first half of 1991, including those held in Prague, Rome and Vienna. Although this subject is important in its own right, this conference should only take account of its actual and potential implications for labour market and social policy. There are fears that large areas will be depleted of their relatively young and skilled workforce, eroding the potential of local administrators to develop effective social policy, for demographic and fiscal reasons, and making it harder to regenerate local economies hit by much higher rates of unemployment than elsewhere. But there are individual and social benefits both for sending and receiving regions that are easily and often underestimated, not least those associated with return migration by those gaining new skills, experience and attitudes.

28. In the near future, bearing in mind the context of inadequate employment services, underdeveloped housing markets and so on, rising migration will be a matter of growing concern for the authorities and peoples in east and west. It will be vital to ensure that migrants and potential migrants are not treated as a scapegoat or threat to society, and to recognise that labour mobility is essential for a more flexible labour market and for structural adjustment.

### III. Policies for Labour Market Restructuring

29. Labour market policies have many objectives, and often too much is expected of them because the objectives are mixed. They will figure prominently in eastern and central Europe in the next few years, as they have in western Europe over the past decade.<sup>F</sup>

•Both the ILO and the OECD have co-ordinated a lot of research on active labour market policies in market industrialised countries, as have other international organisations, such as the European Commission. This is not surprising, given the wide range of policies attempted and the numerous countries that have resorted to them.

<sup>F</sup> They will be expected to (i) cut unemployment, (ii) reduce labour market segmentation and the disadvantaged position of various groups in society, (iii) promote geographical, occupational and industrial mobility, and (iv) raise labour productivity. And underlying everything, they will be expected to move the labour market from over- and low productivity employment to low unemployment and high productivity employment.

30. In the initial stages of the reform process in many of the countries of the region, the striking feature of government responses was the passage of comprehensive "framework" employment laws. The USSR's {Fundamentals of } {Employment Legislation of the USSR and the Union Republic}s, adopted in January 1991, came into effect in July 1991; individual Republics have introduced their own versions of an employment law. In the CSFR, the {Law on Employment} was introduced in 1991, and in Hungary the strands of earlier partial reforms were integrated in a comprehensive law on employment introduced in February 1991. There and elsewhere, such laws have created the basis for a wide array of labour market policies, ranging from income transfers to public works and labour market retraining schemes. In essence, they represent the first steps to a new form of regulated labour market.

31. Among the issues raised by assessments of labour market policies are identification of the most appropriate administrative structure. Which level of government should be responsible for the design and implementation of the labour market policies that such Acts presage? And should the government alone be responsible or should such policies be determined by some "tripartite" mechanism, as operating in Scandinavia, for instance? This set of issues must be taken up.

32. The whole range of measures contained in the new employment laws correspond reasonably closely to recent policy developments in the west. Increasingly, governments feel that labour market policies should not rely on one or another instrument but that the mix of measures makes a difference. Often, measures are classified as "passive" (transfers) and "active". Although the concept of active labour market policies, as developed in the 50s and 60s, has been implemented with some success in a number of European countries, any such rigid classification over-simplifies and creates unnecessary difficulty in policy design. The crucial issue is how to develop a policy mix that combines income protection for the unemployed with reintegration into productive and gainful employment, without contravening principles of freedom in the labour market. Recent experience with labour market policy suggest that reintegration should start as early as possible, as the difficulties become disproportionately greater as duration of unemployment flows.

33. To function adequately, all these policies depend on the existence of an adequate network of employment services, including labour exchanges. Nowhere in eastern and central Europe has such a network existed. Great efforts -- and

in some cases considerable international financial assistance -- have been devoted to developing employment services. Until they have taken shape -- and perhaps not even then -- it will be difficult to estimate unemployment accurately or to operate conditional unemployment benefits with even reasonable efficiency.

a. Unemployment benefits as labour market policy

34. Once governments legitimised unemployment, they were bound to introduce some form of unemployment benefits, often through adoption of benefit systems believed to operate in specific industrialised market economies.

35. Whether unemployment benefits systems based on social insurance can provide social protection for those most hit by the industrial and socio-economic restructuring is an issue for the session on social policy. However, they are part of the armoury of labour market policy. Most forms of transfer actually play multiple roles in the labour market, and may have features designed to increase or reduce labour supply, redirect it or regulate certain forms of economic activity. Unemployment benefits are a typical case of a policy mechanism with potentially conflicting social and labour market objectives, and as such raise crucial issues for policy makers in eastern and central Europe that are not as easy to resolve as some statements would suggest. Among those issues are the following:

- i) To what extent should unemployment benefits (or other transfers) be conditional on labour market behaviour, such as past work record, method of leaving past employment, job-seeking activity, employment exchange registration and wage-job aspirations?
- ii) Should benefits be paid for a short period only, to induce a quick acceptance of some sort of job, or for a long period as long as the unemployed satisfies some labour market criteria or, as in the United States, for a period that would depend in part on the overall level of unemployment?
- iii) Should there be some "workfare" elements, i.e. an obligation on the unemployed to perform some work-related activity as a condition for benefit receipt? Would that help in the reintegration of the unemployed into the mainstream labour force? (As noted later, we have serious reservations about this approach).
- iv) Should benefits be provided on a different basis for different groups in the population, on the grounds that, supposedly, they face different opportunities, have different needs or could be expected to satisfy labour market behavioural criteria to a greater or lesser extent than other groups?

36. The questions are posed starkly, and the theoretical and empirical research on them in the market industrialised countries is extensive and controversial. How such questions are answered will determine the type of labour market that evolves. And clearly it would be useful to clarify the criteria by which social transfers should be assessed. They may be more or

less efficient or equitable than some other policies designed to regulate or restructure labour force behaviour or outcomes. Mobility grants, for example, combine income transfers with the possibility of improving labour market efficiency. However, transfer systems are the core of labour market policy.

37. In that regard, in central and eastern Europe, besides what seem to be increasingly conditional ("targeted") unemployment benefits, it seems that most countries have been slow to develop income-support schemes for vulnerable groups. These require a well-developed employment exchange system, operated by a well-qualified staff. Minorities, youth, women with small children, older workers and those with physical disadvantages all face extra difficulties in the labour market likely to necessitate extra financial and direct assistance.

38. Throughout the region, the development of employment services is a major policy priority. Not only were the old employment offices expected to fulfil a different role from what employment services are expected to achieve in a well-functioning labour market, but the number of offices and staff were minimal. This reflected, in large part, the "overfull" employment.

39. Designing and implementing an effective and equitable network of employment services could be, and probably should be, the subject of a whole conference. However, for placing them in the general context of labour market policy, perhaps the main issues are the following:

- i) Most fundamentally, what should be the main functions pursued by the employment services?
- ii) Should the employment exchanges involve obligatory registration of job vacancies as well as obligatory registration by jobseekers wanting unemployment benefits? And should services be provided "free" to potential employers and jobseekers?
- iii) Should the functions of labour market information and career guidance be separated in some clear way from the functions of labour market regulation and, in particular, administration of unemployment benefits?
- iv) To what extent, and how, should employment services be selective in their treatment of different groups, trying to reduce labour market segmentation and stratification?

40. In eastern and central Europe, the nature of the employment services will have to change and it will take some time before they can overcome the stigma associated with having had a peripheral, directional role in the command economy system. But it will be essential to develop them in tune with the more flexible, informal labour markets that are likely to predominate in the 90s.

#### b. Labour market and on-the-job training

41. To curb unemployment, to raise productivity, to increase labour mobility and to help integrate or reintegrate disadvantaged groups in the labour force -- great expectations are placed on three forms of government-assisted skill formation.

42. First, there is general and vocational education, which is extremely important and needs to combine cultural and economic elements. In the forging of economically viable societies for the next century, implementing effective "human resource development" strategies will be vital and will need to be based on broadly-based and flexible educational policies, rather than on systems that heavily orient students to currently available jobs.

43. In addition to general and vocational education, great hopes are placed on labour market training schemes and on complementary on-the-job training and retraining schemes designed to keep workers in employment or enable them to change jobs without a period of unemployment.

44. Much may be said in favour of the numerous variants of these policies that have sprung up in recent years in market industrialised countries. It is advisable to bear in mind their limitations. Training is not an all-purpose recipe for labour market adjustment, and it is too easy to inflate its role because "training" sounds so appealing.

45. A first difficulty is identifying the type of training needed. Thus, in eastern Europe it seems to be widely believed that the overall level of skills is inadequate for the new types of employment, so implying an enormous need for major new training schemes. However, how are the specific training needs to be identified? If they are not identified, on what basis can one conclude that large amounts of scarce resources should be devoted to training programmes?

46. Certainly, there are grounds for scepticism that current vacancy data are an appropriate guide to the training needs; they rarely are appropriate in any country. Using vacancy indices is surely not the best, or only, way to design training programmes.

47. Moreover, in the particular transitions to more open labour markets, training oriented to a broad range of market-oriented qualifications and use of new technologies will surely yield a higher social and private return than if oriented to current, known vacancies. This is always likely to be the case in periods of structural adjustment. It is the implications of that principle that would seem to constitute the main issue.

48. Experience outside the region suggests that those economies that have been relatively successful have been those that have developed training schemes with an eye to long-term technological and industrial restructuring. However, the question is how to translate this principle into viable schemes for the unemployed in need of immediate, practical skills.

49. Among the numerous issues connected with labour market training schemes as labour market policy are those concerned with monitoring and evaluating them, two quite distinct activities that are equally essential in a context in which much is expected of the careful allocation of very scarce resources. Even in western Europe, it is probably fair to say that proper evaluations of training schemes have been rare. The two main limitations of such schemes that justify caution in advocating massive programmes are what are called "deadweight" and "substitution" effects. Thus, if a government subsidises

labour market training, it may be unnecessary because the training would have been carried out in any case. It is a deadweight because the resources could have been used in a more productive manner. A substitution or displacement effect arises because the (unemployed) person who receives the training may merely take the place of someone who was employed or who could have done the job perfectly adequately.

50. These notes of caution should not be interpreted as "anti-training", merely as a statement that the issue is more open than is often recognised. What is clear is that the reality in many parts of the six countries under review is that many large industrial enterprises, in responding to their financial pressures by cutting back on many forms of investment, have cut their training schemes considerably; some have shut down their training facilities altogether.

51. In such circumstances, how should governments react? One option would be to detach training institutions from industrial enterprises and to run them directly. The German authorities have begun to use their privatisation agency, the Treuhandanstalt, for this purpose. This is likely to be particularly advisable because huge centralised training institutions seem out of tune with the more flexible labour markets of the 90s. Another option is to provide subsidies to encourage enterprises to maintain or initiate training. This could help new small-scale enterprises, in particular. Assisting skill formation in these will be among the major labour market policy challenges in the next few years.

#### c. Public works

52. Another policy on which perhaps excessive hopes are placed is direct job creation through short-term public works. These have figured prominently in legislative reforms, as in the case of the new employment law in the USSR. Usually the main objective is to cut unemployment directly, saving unemployment benefits in the process. Certainly, there is ample scope for social and physical infrastructural improvements in all countries of the region. However, public works schemes have often been criticised for being costly and for failing to provide the unemployed with effective ways of being reintegrated into the economic mainstream. Usually involving relatively "unskilled" jobs with low pay and little long-term potential, they may attract a stigma, so undermining rather than strengthening worker motivation and morale. With such schemes, there is the prospect of a recurring cycle of short-term jobs interspersed with periods of unemployment. Although more costly in the short-term, schemes that combine training with work experience may be more successful, but only if participation in them is voluntary.

53. Finally, it has to be recognised that deadweight and substitution effects may be considerable here as in the case of training schemes. Moreover, if a government funds or organises a public works scheme it may "crowd out" a non-government project -- or even another government scheme -- so having little or no net effect on unemployment.

#### d. Employment subsidies

54. Another much used policy during periods of high unemployment, and one being utilised implicitly as well as explicitly by the eastern and central European countries in their current phase of stabilisation and adjustment, is the provision of wage subsidies to keep workers in some form of employment. These have become increasingly popular as the rise of unemployment has started to accelerate. For instance, Poland has introduced an incomes policy that, inter alia, encourages the preservation of low-paid employment, and Bulgaria has considered subsidies for state enterprises as long as they maintain some past level of employment. In some of the countries, workers have accepted pay cuts or paid or unpaid leave in return for keeping jobs with their enterprise. For workers that option is attractive, since they retain entitlement to enterprise-level benefits as well as a niche for when, or if, employment prospects improve.

55. What can be learned from the application of Kurzarbeit (short-time work) in eastern Germany? Many industrialised countries have used similar schemes in an attempt to achieve a socially acceptable adjustment process and to preserve skills. A well-known case is the Cassa Integrazione scheme in Italy, utilising unemployment insurance during temporary lay-offs. All such schemes have the advantage that they provide income support for de facto redundant workers, avoiding open unemployment without disguising the fact that adjustment is needed. Yet there are drawbacks as well, including the tendency for widespread deadweight and substitution effects.

56. One recent development in western Europe that perhaps deserves more attention is the attempt by various large enterprises, or whole state-dominated industries, to keep workers in employment, despite labour surplus conditions, by combining subsidies with retraining or enterprise-creation schemes. Perhaps this type of approach could be useful in central and eastern Europe in the important phase of restructuring of state enterprises.

#### e. Start-up Measures and Mobility incentives

57. While there should not be excessive expectations about the employment impact of direct job creation and training schemes, is there scope for speeding up the process of job creation? As it seems that in the near future most new jobs will be in new small-scale enterprises, including self-employment, this issue is linked to the more general one of enterprise creation. Major obstacles to the spread of new productive enterprises include lack of credit, lack of marketing skills and lack of entrepreneurial experience.

58. Can such difficulties be reduced? To what extent, if any, should financial resources devoted to other forms of labour market policies and income protection be redirected to try to stimulate such small-scale enterprises? The relevance of such questions is strengthened by the fact that the new employment laws include provisions dealing with the support of such enterprises.

59. Mobility grants are a means of enabling workers to move to where there are opportunities to start up new businesses as well as obtain wage jobs. In



western Europe there have been long debates on whether "jobs should be taken to the workers, or workers taken to the jobs". Besides the obvious answer that both are desirable, a key advantage of labour mobility grants is that they should tend to reduce regional disparities in unemployment, wages and benefits, particularly important in a period of industrial restructuring. But once again it is surely advisable to recognise the potential deadweight and substitution effects.

f. Labour policies for vulnerable groups

60. Recalling the emerging patterns of disadvantage and labour market segmentation, and the fact that these are endemic to open labour markets, it is clear that labour market policies have responded in different ways to each of those groups regarded as in some way vulnerable in the labour market. Though there are undoubtedly other groups that deserve attention, such as minorities and those who have work-constraining handicaps, we focus the following on the three major demographic groups that have received most active consideration.

Older workers

61. Because they are often the first and most seriously hit by industrial restructuring, it is perhaps appropriate to start with workers aged in their 50s and 60s. Typically they are pushed out of manual jobs in heavy industries, and the policy options seem limited, though they may not be. In circumstances of rising overall unemployment, most governments in east and west have not resisted the temptation to try to reduce labour supply, by means of incomes transfer policy.

62. Early retirement schemes adopted in many west European countries in the 80s to reduce the labour supply of older workers hit or likely to be hit by redundancies in the heavy industries have been controversial. Perhaps for different reasons, somewhat similar schemes have been introduced in central and east European economies. A criticism is that they easily lead to labour market discrimination against older workers, both by employers and by the employment services, thereby contributing to worsening poverty among older workers needing income-earning work and to their social marginalisation, particularly in times of high unemployment.

63. In any case the difficulty of resorting to that policy now is considerable. The average age of retirement in central and eastern Europe has long been much lower than in the rest of Europe, nearly five years lower in the case of men (60 compared to 64.4) and up to eight years in the case of women (55 compared to 63).<sup>F</sup>

In practice, "early retirement" for special categories of workers in Eastern European countries meant aged 50-55 for men and 50 for women.

In some of the countries, up to 20 per cent of the working age population were in early retirement for special "hardship" reasons.

<sup>F</sup> There must be strong grounds for raising the pensionable age, at the same time as raising the level of pensions, which have been unacceptably low. It might be claimed that this may fuel the unemployment rate at a time when concern to reduce unemployment is uppermost. However, this assumes that older and younger workers are substitutes, which is far from certain.

64. The appeal of another labour supply reducing policy has been gathering momentum and should be a cause for some concern. This is the steady displacement of employed pensioners. In some countries, such workers have

accounted for a significant share of total employment; in Hungary, in 1990 the figure was 8 per cent. While many of these have remained in jobs because of inadequate pensions, there must be a fear that as unemployment rises there will be discrimination against older workers in general, which could worsen their already fragile standard of living. This tendency should be seen in the context of the type of jobs that such older workers perform. Are they really the type that would be taken by young workers wanting full-time employment?

65. Finally, there is the option of increasing the labour supply and employment prospects of older workers. As in western industrialised countries, in the longer-term that will be essential given the "greying" of the labour force, if not the fiscal imperative of reducing the dependency ratio.

66. Efforts to reintegrate older workers displaced by industrial restructuring or threatened by redundancy include measures reserving certain types of jobs for older workers, retraining schemes and the provision of subsidies to employers prepared to hire or maintain them. All are likely to be controversial. Perhaps the most promising are policies to encourage work-sharing, at least until such time that decent pensions are feasible, after which the state might become more neutral in its attitude to such forms of economic activity.

67. What surely is worth stating through this conference is that older workers should not be seen as the "easy option" for labour market marginalisation. They deserve to be considered as active participants in the transition process.

#### Youth

68. At the other end of the age spectrum, policy makers faced by rising youth unemployment may be inclined to reduce their labour supply, boost their employment directly and/or improve their competitive position in the labour market. All three approaches have been pursued with considerable intensity in the market industrialised countries over the past decade, and in some cases for much longer.

69. The first set of issues concerns the scope for reducing the short-term labour supply, usually with an eye to improving its quality in the longer-term. The most direct way would be to increase the age of compulsory schooling, which might or might not have other advantages. Other mechanisms -- all of which have advantages and disadvantages -- might include job-sharing schemes or partial wage subsidies, so as to permit skill training at the same time.

70. To boost youth employment directly, one option is special youth public works schemes, perhaps along the lines followed in Sweden or the United Kingdom, for instance. This tends to lead in the direction of "workfare", and is controversial. Critics of workfare believe that it is inconsistent with a free labour market to oblige young workers to perform predetermined activities as a condition for receipt of benefits. More generally, will public works schemes involve mostly "dead end" or low productivity jobs that, rather than improve the long-term commitment of young workers to labour market activity, could impede that development?

71. Finally, policy makers could try to improve the employment prospects of young workers. They could encourage a more rapid integration of young workers into the labour market by extending labour market training, vocational schooling or subsidised on-the-job training. Or they could provide wage subsidies and special grants to encourage entrepreneurship.

72. The most discussed policy is vocational training. This is a complex issue, made the more so as the number of youth is growing quite rapidly, making the cost of providing initial training increasingly onerous.

#### Women workers

73. One of the advantages of the high female labour force participation rates in eastern and central Europe is that women have become an integral part of the labour force, and will be there in large numbers when labour shortages emerge in the late 1990s. It would be inappropriate for that among other reasons for policy makers to attempt to reduce female labour supply.

74. As for women workers themselves, labour market policies can reduce the possibility that with greater reliance on market mechanisms and with high unemployment they may be turned into a "secondary" labour force. One well-rehearsed issue in market economies is whether or not labour market policies should discriminate in favour of women and other groups likely to be disadvantaged in the labour market. In most periods of rising unemployment, there are those who argue that women should be given fewer opportunities because that would open up more opportunities for "male breadwinners" and therefore improve family welfare. This reasoning is surely unacceptable, since -- even besides the fact that many women are their household's primary earner -- a basic principle to be strengthened within the labour market is that every individual should have equal opportunity.

75. One issue likely to figure more prominently in policy debates is whether the promotion of part-time employment for women workers (and others) is appropriate or feasible. In most market economies part-time jobs have grown relatively to full-time in recent years. This source of employment has been little developed in the formal economy of east European countries.

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76. In sum, labour market policies can be valuable for improving the labour adjustment process and for reducing the level and maldistribution of unemployment. But most have their limitations. It is as well to recognise the possibilities of deadweight, substitution and "crowding out" effects in the current atmosphere, and to recognise the need for careful evaluation of all labour market policies, including income protection measures, training and public works.

77. While all such schemes may have the virtue of enabling the unemployed, particular the long-term unemployed, to have opportunities to be reintegrated into the labour force, nevertheless if the work is "dead end" or if there are no job opportunities at the end of the training, a mood of disillusion may soon undermine the positive potential of such policies. While it is vital to

remember that active labour market policies work best when the level of aggregate demand for labour is close to full employment, there is much that can and ought to be done in current circumstances.

#### IV. Labour Market Issues of Social Protection

78. With rapid industrial restructuring, drastic falls in national income, rising unemployment and price liberalisation combined with drastic cuts in consumer subsidies, governments in all countries of the region have had to reform their systems of social protection. Under the old regimes, social policy was highly centralised, closely linked to employment in state enterprises and organisations and essentially foregoing an "incentive" function. While it is generally agreed that the old system is inappropriate for the new challenges, there is less agreement on what the new system should look like.

79. There are numerous issues to be resolved, most concerned with the urgent and fundamental need to limit and prevent poverty and destitution. However, in the relevant sessions of this conference we recommend that discussion concentrates on aspects of social policy linked to labour market developments.

80. There are three fundamental contextual issues. In the central and east European economies, it has been argued that total expenditure on social policy relative to their level of GDP per capita was excessive. This may be true if social policy is defined in its widest sense, including its regulative and administrative aspects. It has also been argued that social policy has been more redistributive than in the market industrialised countries. The latter may be untrue as a generalisation, but both possibilities raise familiar questions about what levels would be appropriate and whether new policies should be more or less redistributive. International experience does not suggest that there is an ideal level of social policy expenditure or any norm for the extent to which policies could or should be redistributive, either within or across generations.

81. The second contextual issue concerns the roles that the various levels of government administration could or should play. In considering what type of market economy will emerge, what should be the respective roles of the several levels of State administration and of non-State institutions in the provision of social protection, both during the transition process, recognising that market insurance-based schemes scarcely exist and in the longer term? One principle is surely that a more decentralised or "federal" network must be created as soon as possible, since local government must play a much greater administrative role, if one accepts that more reliance will have to be placed on social assistance or basic income transfers to limit destitution among the long-term unemployed and other threatened by social marginalisation and "underclass" status.

82. Finally should a distinction be made between income protection policy during a period of transition that is presumed to be short and the system of social protection that will be desirable in the longer term when a "market economy" has been created?

## "Social Safety Nets" and "Targeting"

83. Some policy makers have indeed distinguished between social policy for the transition and long-term social security reform. The idea of special social policy measures for a period of major restructuring has precedents. In western Europe, in the post-war reconstruction period measures such as rationing of basic consumer goods and selective price were used. Now, in eastern Europe the idea of a social "safety net" is popular as a response to immediate difficulties.

84. Two arguments in favour of providing a safety net directed at the poor is that the rapid economic changes require special assistance for certain identifiable groups and that a more general scheme of social protection would run into severe funding difficulties. This would seem to raise some awkward questions.

85. Most fundamentally, is effective social protection feasible with tight budgetary constraints, and does the fiscal factor justify a highly targeted "conditional" approach to transfers? Is the notion of a "safety net" consistent with a highly "targeted" approach to benefit provision? Targeting has become a euphemism for providing benefits only to those deemed by the authorities to need them. But is such targeting feasible in the circumstances faced by countries of the region, without serious administrative and equity consequences?

x86. At the outset of the reform process, most new Governments were drawn to introduce relatively generous unemployment benefits. But fiscal constraints led to a reshaping of the schemes and a tightening of conditions for benefit receipt. It is likely to remain a contentious issue whether more selective, targeted benefits, paid to recipients for a shorter period than the expected period of job-seeking unemployment are justified in the circumstances faced by the east and central European economies. Whether justified or not, one can predict that there will be agonising debates over the labour market and social equity effects of more conditional benefits.

87. There may be one other principle worth stressing. The less developed the local administrative network of employment and social security services, the more simple the system of basic income transfers should be. If social assistance is applied only when fulfilling a strict set of conditions, many of those in need will fall through the safety net. The strengthening of local authorities' role in social protection will surely be a major task in the next few years, but in the meantime it might be questionable if complex eligibility and targeting were applied to poverty-reducing transfers as if they already functioned well.

## Of "incentives" and distribution

88. It is generally agreed that the old system gave little attention to the possible incentive function of social policy. Yet should social protection policy have an incentive objective as a primary feature, and if so how? What are the distributional and labour market efficiency implications of taking that approach?

89. Under the old regimes, social policy was highly centralised, and was also closely linked to employment in State enterprises and organisations. As privatisation proceeds, and unemployment and intermittent labour force participation become more common, how will the old unified enterprise-based social protection become more differentiated without some groups being seriously disadvantaged? It is probably fair to say that this is one of the great unresolved issues of social policy in market industrialised economies -- obtaining a lasting marriage of equitable welfare with efficient incentive properties.

#### Flat-rate and earnings related benefits

90. To what extent should social protection policy rely on flat-rate or earnings-related benefits? If wage differentials are narrow, an earnings-related system of income transfers is not very different from a flat-rate benefit system. But if wage differentials grow, as is expected, during the current period of structural change, is it appropriate for the State to move in the direction of flat-rate benefits? If so, should the benefit-earned income ratio (the replacement ratio) decline for successively higher income groups, or should income differentiation be reduced by taxation? And what are the implications of moving towards earnings-related benefits for social solidarity during the transition process?

91. Flat-rate benefits have been supported by most international organisations. Yet all the countries in the region have felt obliged to introduce earnings-related schemes -- Hungary in 1989, Bulgaria and Poland in 1990, the CSFR, Romania and the USSR in 1991. Recently, some countries, such as Bulgaria, have started to reduce the earnings-related component, but it is unclear which direction will predominate.

92. Evidently, a major issue has to be resolved. It would be good if the conference session devoted to social protection could clarify the advantages and disadvantages of each approach, bearing in mind the rising inflation and the existence of the "second" or "informal" economy. The great merits of flat-rate schemes would seem to be that they are simple, efficient, transparent, easy to administer -- both in terms of setting up and operating -- and more likely to be fair because they involve fewer or no income or means tests. Although the distinction between flat-rate and earnings-related schemes may diminish during a period of high inflation and partial indexation, a well-known drawback of earnings-related schemes is that the long-term unemployed are left to fall back on inadequate, means-tested social assistance.

#### Price liberalisation and compensation policies

93. The alacrity with which governments have cut consumer subsidies and liberalised prices has not only had the predicted inflationary consequences but might have left many millions of people in the region exposed to poverty or income insecurity. Perhaps a more gradual liberalisation of prices would have been easier from a social point of view, but it was decided that rapid liberalisation was crucial to increase incentives and remove supply constraints to production.

94. Governments have tried to cushion the blow by compensation schemes, but these seem to have had mixed success, partly because it has been hard to compensate all groups with equal success. What form of price compensation is to be preferred? Should compensation payments be flat rate or graduated for groups according to income, labour force status or perceived need according to socio-demographic status? And who should pay the direct costs of the compensation? If employing enterprises are expected to pay, they may be induced to reduce employment at a time when unemployment is rising for a host of other reasons. If the social security system is expected to pay, through increased pensions, family allowances, supplements to unemployment benefits, etc., then that will almost certainly require budgetary transfers from central or local government, and will probably lead to a reduction in ordinary benefits or to more narrow targeting, which invariably intensifies problems of social exclusion. This issue has exercised policy makers in the CSFR in particular, but all countries have had to explore alternative options.

#### Pensions, sickness benefits and family assistance reform

95. As noted in section II, the position of older workers is causing concern throughout the region, with many being pushed into unemployment or premature retirement, many having to rely on meagre pensions that used to be combined with low wage employment. The problems are compounded by the low life expectancy in many industrial areas and, perhaps paradoxically, the very high old-age dependency rates. Pension reform is long overdue. Besides their low level, combined with the fact that workers have been entitled to them at a relatively early age, pensions have suffered from being inadequately linked to labour force behaviour. If workers retired early they could still obtain approximately the same pension as those who did not because the number of years of pensionable work to qualify for full pension was small, with only small increments for later retirement that fell below what they could earn from post-retirement work. There are other problems, but for this conference perhaps the two most crucial principles to be stressed are that for those in their early 50s, in particular, there should be incentives to remain in the labour force and for all workers there should be a reasonable prospect of a decent pension at a reasonable retirement age.

96. Although it has also been a widespread phenomenon in some industrialised market economies, work absence due to worker sickness is a considerable phenomenon in many of the east and central European countries. Hungary, for instance, has one of the highest sickness absence rates in the world. There are reports that much of such absence in all the countries of the region has been induced by the system of sickness pay, which allowed workers to take time off with impunity, perhaps to work in second jobs, facilitated by the artificial labour shortage. Although this may have been the case, there is also little doubt about the high levels of morbidity in the region, due to the nature of the main industries, extensive pollution and poor working conditions.

97. The main task is easy to state. Workers and managers must have more incentives to reduce sickness-related absence and outlays on sick pay. It is apparent that in state enterprises operating with a "soft budget constraint", management (except in periods of intense activity) has had little incentive to

reduce such absence, since the compensation has come from the general, government budget, rather than from the wage fund. With privatisation, if that system persisted, employers would have a very strong incentive to put surplus workers on sick pay rather than pay them wages or lay them off, while workers would prefer that to unemployment, because they would retain their job and receive a higher income replacement rate.

98. The alternative routes are to make employers wholly or partially responsible for sickness benefits or to oblige workers to lose pay for a few days before they start receiving sick pay. Bulgaria, Hungary and the CSFR have all begun to move in the latter direction.

99. Family benefits have been high as a percentage of GDP in central and east European economies compared with other European countries, though less so if tax credits are taken into account in the latter. In the former, an important factor was that family benefits were boosted by the existence of indirect benefits, such as preferential housing for families. Whatever their full value, family benefits were intended to supplement low wages and sometimes rationalised by reference to a pro-natalist policy. The low wage, high benefits policy was a long-term trend due to the official view that under communism wages were supposed to wither away. Perhaps the most controversial issue for social policy is whether family benefits should be targeted via means tests and work availability tests or made into a universal form of income transfer. As with other benefits, should family benefits be related to the average wage or to some index of subsistence income?

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100. The list of issues that we have identified is no doubt incomplete, and it is to be hoped that participants will raise others if they think they deserve as high priority and to the extent that they relate to labour market behaviour and policy development. It is also hoped that discussion will suggest ways by which policy makers could clarify their own responses by obtaining a comprehensive assessment of the options and the arguments for and against each of them.

#### V. Wages and the Question of Incomes Policy

101. Real wages were always low in eastern and central Europe, and with the economic decline of the past two years the fall in real wages experienced by many groups of workers has been a painful process. At the extreme, real wages fell by 40 per cent in Poland between December 1989 and December 1990, and in 1991 some countries are likely to experience declines of that order of magnitude. Whereas in the 1980s, real wages in the region declined while full employment was maintained, more recently both have been falling. Admittedly, in the past few years it is not clear whether real wages in terms of purchasing power have declined by as much as seems to have been the case. The country papers provide a wealth of information on recent trends, but one of the difficulties has been that the statistical base for assessing those trends and their implications have been patchy. One aspect is that the data must be interpreted with caution, particularly when it comes to making international comparisons on wage structures and wage differentials.



102. Few doubt that real wages must sooner or later rise in all the countries of the region to what they were before 1990, because unless they do the undervaluation of labour input will continue and prospects for productivity growth will be impaired. Even more importantly, worker living standards will decline precipitously, given the shrinkage of the role of the State (and enterprises) in the direct provision of goods and services. However, this raises the fundamental issue of the appropriate mechanisms for wage determination. There is a strong debate in industrialised market economies about the relative merits and demerits of centralised and decentralised pay bargaining, the conventional wisdom being that for macro-economic and labour market performance a very centralised and a very decentralised system both perform better than the intermediate case.

103. We then come to the issue of wage differentials. In many respects, both wage structures and wage differentials in east European economies have been similar to those found in the market industrialised countries. Yet many economists and politicians have claimed that wage differentials have been too narrow, that there has been excessive "levelling" through administrative meddling and that effective labour utilisation and labour mobility have been impaired by the narrow and rigid wage differentials.

104. The evidence is not convincing. In many of the countries the pattern of wage differentials has been similar to that found in the industrialised market economies, though in some the data suggest that they may be somewhat narrower. The issue now is whether a large widening of differentials is necessary or desirable as the means of securing labour reallocation and higher labour productivity. And in any case, as long as most employment remains in large State enterprises, it is difficult to see how systems of state regulated wage scales can be abandoned, although in the longer term the basis for wage differentials should surely change to reflect skill, work performance and relative productivity. The feasibility of determining relative wages by reference to job classification schemes has been explored as an option in such circumstances. But it remains hard to define wage scales to reflect relative productivity and labour scarcity.

105. Traditional bonus systems that were based on material production targets have been shown to have been inadequate in eastern Europe, but the attempted use of productivity incentive schemes has run into objections, primarily connected with the fear of rapid wage inflation and the emergence of massive wage inequality due to some workers being able to raise productivity by large amounts.

106. While there is a continuing collapse of the old administrative mechanisms for pay determination, a general widening of wage differentials and an erosion of incomes at the bottom, one pressing issue is how best to protect the lowest income earners in the labour market. This raises the unresolved debate over statutory minimum wages and the desirability of wage indexation. The basic argument in favour of both is that vulnerable groups need to be protected against declines in living standards due to price increases and against cuts in wages due to unemployment or other labour market factors that put them in weak bargaining positions.

107. Most market-oriented countries maintain some sort of minimum wage protection. But they raise familiar objections from some economists, who claim that (i) they price vulnerable workers out of jobs, thereby pushing up unemployment; (ii) they only protect a small minority of workers; and (iii) they discourage some labour-intensive industries and thus hinder job generation.

108. Among the counter-arguments are that they help to raise productivity, both by inducing workers to work more effectively and by encouraging firms to value and train workers more diligently, rather than treat them as "cheap labour". Although the debate is unresolved, it may be better to provide basic income security by means other than statutory minimum wages.

109. While wage protection has preoccupied some economists concerned with the lower end of the labour market, many more have been concerned about the almost unprecedented increases in nominal wages in recent months. This has been due in part to price liberalisation and the erosion of old systems of centralised administrative control over wages, and to the opening up of the region's economies to international market forces. Whatever the factors involved, the wage pressures have led to a desire for some form of incomes policy.

110. Since the 1970s, most market industrialised country governments have moved away from incomes policy, because of disillusion with statutory incomes policy. The conventional view is that they cannot work very long, bottling up inflationary pressures that produce a wage-price explosion and intensifying labour market rigidities. Given that mood, it is worth noting that some form of incomes policy has worked quite well in past periods of reconstruction, notably after the Second World War. And some countries continued to operate and refine incomes policy during the 1980s, for example Finland, with some notable success. The scope for negotiated incomes policy is best left to the next section, on industrial relations.

111. As far as eastern and central Europe is concerned, the main form adopted so far has been some variant of a tax-based incomes policy. This has been pushed by several international organisations, but it is notable that it has not been introduced in market industrialised countries.

112. The basic idea is that to limit the growth of nominal wages, any increase in wages above some stipulated level should be taxed at a punitive and possibly progressive rate. The tax threat is meant to deter wage increases so as to reduce the chances of hyper-inflation. The rationale is simple. Since large state enterprises still predominate in the region, management does not act as the representative of owners, so that they are too easily persuaded to grant excessive wage increases which are not justified by productivity growth, or if justified by enterprise productivity are inflationary, raising nominal incomes in circumstances where there is no increase in the supply of consumer goods and services. Where the State enterprises are still domestic monopolies the likelihood of such wage concessions is all the greater. Only if a "hard budget" constraint exists, that is, if there are adverse consequences for managers if wage or other labour costs are allowed to rise unjustifiably, resulting in lower market shares, or declining sales or profitability, will there be effective control over wage increases at the enterprise or industry levels. This has been the main justification for a tax-based incomes policy.

113. However, there are drawbacks, which may be sufficient to reject it. The standard model of a TIP is for enterprises to be allowed to raise their wage bill up to a threshold level to compensate for price increases, or some percentage of past or anticipated price increases. Among the criticisms is that this does not focus on individual wage rates, so that it does not link to inflation at an individual level. Perhaps more significantly, the TIP can penalise or discourage the growth of production or productivity.

114. It is also possible that a rigid tax rule would lead to a shift in relative wages in favour of "insiders" at the expense of groups in a weaker bargaining position. And a tax on the total wage bill encourages labour shedding and this may not be desirable at a time of steeply rising unemployment. That seems to have been a reason for Poland modifying the policy to one of a tax on the average wage. Unfortunately, that too seems to have drawbacks, including the tendency to encourage the use of low-wage, low-skill labour rather than a policy of upgrading. It also discourages enterprise-level bargaining between unions and employers by limiting the scope for productivity-enhancing wage deals.

115. The desirability or otherwise of tax-based incomes policy should be a prominent issue. Some governments have contemplated abandoning this route and have sought to find ways of limiting the inflationary consequences of higher wages by other means. Others have considered coupling a TIP with steps towards a negotiated incomes policy, which depends crucially on the existence of effective, representative bargainers, the subject of the next session.

## VI. The Evolution of Industrial Relations

116. The old centralised system left little scope for bargaining between managers and workers; formally, conflicts of interest between workers and managers were not recognised, while unions were more a part of management than bargainers with it. Since then, there has been the tentative emergence of independent organisations representing employers and new forms of trades unions more detached from the organs of government.

117. It is too early to say which institutional form of industrial relations will predominate. As the session devoted to this issue will surely demonstrate, it is a period of experimentation, in which fragmentation of institutions will probably precede consolidation and multi-layered bargaining at the national, industrial and enterprise levels. In one or two countries, a unified trade union movement has been recreated, after radical changes in existing organisations, in others such as Romania the fragmentation has been very considerable indeed. In the latter, one can anticipate a process of consolidation but the final outcome is hard to predict. Will the learning process in collective bargaining make such fragmentation worse and even undermine the long-term legitimacy of trade unionism?

118. A major fear, of course, is that whatever level of wage bargaining develops, it will lead to more inflation and more unemployment, particularly in the "transition" period, during which new unions and new union leaders have to secure legitimacy with their actual and potential members, and employers feel they have to demonstrate their "right to manage", by demonstrating successful

bargaining prowess. Those factors, coupled with a lack of mutually shared information about what each side has to offer and about the likely consequences of their actions, will impede identification of points on which to compromise.

119. The fear of accelerating inflation and unemployment while free collective bargaining is evolving is perceived by some as an argument in favour of tax-based incomes policy, and for it to be maintained for a rather long time. However, surely this would seriously limit the scope for, and meaningfulness of, for collective bargaining. It would also confuse rather than clarify the respective roles and interests of workers and trade unions, employers, management and government. As long as regulatory and administrative mechanisms are used to determine wages, including taxes, there will be a tendency for workers and management to coalesce to circumvent government policies.

120. Some governments have been attracted by the policy of statutory control over wages and benefits in "essential industries and services", most notably the energy-related industries. Workers in such industries have a powerful bargaining position, so that they can relatively easily obtain high wage increases. Is it appropriate to introduce compulsory arbitration and mediation procedures, as some governments have done? And would it be reasonable, as some believe, to declare strikes in certain areas or sectors illegal? A point that deserves careful reflection in this phase of consolidation is the possible effects of such policies on the longer-term development of tripartism and collective bargaining and ultimately on democratic institutions more generally.

121. In the continuing search for the appropriate system of labour relations, some form of "tripartism" will emerge, probably with the Government playing an active role in the search for new forms of social consensus. But it would be very surprising if the institutional structures were to be similar in the different countries or identical to any structure in western Europe.

122. In this phase, it may be a crucial task for policy makers to help to determine which bargaining levels -- national, regional, industrial, local or some combination -- are most appropriate for specific forms of labour relations -- wages, benefits, working conditions, job structures, and so on. It will also be part of that process of social bargaining for the State to take over functions that had been left largely to the old state trade unions, most notably the provision of non-wage benefits.

123. One long-term issue is that there is a possibility that widespread de-unionisation will accompany the shift to a more open labour market system, primarily because of the difficulty unions have in establishing a legitimacy among workers as much as anything else. Undoubtedly, the proportion of the working population belonging to trades unions will decline from the artificial figures of over 90 per cent that have been typical, and that were scarcely representative of the real appeal of the former state controlled organisations. But if the erosion of unionisation per se leaves worker representation enfeebled, there will be profound implications for labour legislation and regulations, for income distribution and institutional mechanisms for social protection and for many other aspects of the labour market.

124. Without effective organisations to represent workers, labour market insecurities for a large proportion of the labour force could become severe, and unnecessarily so. That is why it will continue to be important for governments to create the legislative framework for genuine collective bargaining and representative organisations to flourish. Would political democracy be able to gather strength in the absence of industrial democracy and the continuous process of collective negotiation over a wide range of labour and social affairs? In this context the increasing participation of independent unions in the reform process is important.

125. The final issue that we wish to raise is the feasibility of negotiated incomes policy, pursued through centralised collective bargaining by representative organisations of employers and workers, with the government more indirectly than directly involved. The prospects of such bargaining depends on the existence of such organisations, and on their credibility and capacity to bargain. In the transition period at least, it must be doubtful whether those conditions exist, but some governments have begun the difficult but potentially valuable task of generating them.

126. Even if they did exist, critics argue that this form of incomes policy is undesirable, claiming that they introduce wage and labour market rigidities and are ultimately inflationary. Only a few countries have succeeded in implementing a consensual incomes policy for any substantial period. However, seen from the perspective of changing attitudes in the industrialised countries, perhaps they will be considered more favourably in the 1990s than they were in the 1980s.....

127. A few derivative questions arise. First, if the drawback concerned the representativeness of the respective bargaining organisations expected to pursue social consensus in the labour market, what if anything could or should governments do? Providing a framework for industrial relations to evolve will have to include regulations setting standards of internal democracy within the organisations, so that, for instance, more vulnerable groups of workers are adequately represented and small-scale businesses are represented as much as the large enterprises. Also, in this context the problem of the property of the former trade unions has to be addressed.

128. The extent to which governments involve employer and trade union organisations in the design and implementation of the reform process will vary between the countries in the region. There is surely much to be learned from the wide variety of approaches developed in other European countries in that respect.

129. Finally, there is the key issue of reforming industrial relations in the large public sector, which will probably remain large for years. Perhaps there is much to be learned from the experience of neighbouring countries, where many major firms have long been in public ownership.

## VII. Concluding remarks

130. As stated at the outset, this paper is necessarily somewhat selective of points of emphasis. It is intended as a general background paper, each section for use in the corresponding sections of the conference.

131. In general, labour and social policy "problems" have been emphasised. This should not be interpreted as reflecting a view that all is gloomy. There are many reasons for believing that, if effective social and labour market policies are introduced, an efficient and equitable regulated labour market can evolve, which will be in tune with the more flexible, high-tech society that will emerge in the 1990s. We hope that the conference will lead to initiatives in each of the areas covered by the sessions, and that there will be ample points on which there is sufficient agreement to be useful for those having to come with terms with what are, by almost any standards, historically unprecedented challenges.

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