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Social Safety Nets in Central Europe: Preparation for Accession to the European Union?

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ABSTRACT (ABSTRACT)

Orlowski examines policy solutions aimed at reducing unemployment and at improving the pension and other social security systems in the European Union.

FULL TEXT

A critical unresolved task of the ongoing economic transformation in Central European countries is the reformulation of social safety nets and income transfers to prepare for accession to the European Union. Existing programs inhibit productivity of labor, delay structural adjustment and prolong high unemployment. If Central European states adjust their social safety nets to those prevailing among the EU members, the results will involve employment-fostering programs, as well as future income transfers, unemployment benefits and other elements not currently provided. This paper examines policy solutions aimed at educing unemployment and at improving the pension and other social security systems.

The economies of Central Europe are approaching the second stage of transformation from central planning to a market-oriented system. In the initial stage, the economic authorities of Poland, Hungary, and the Czech and Slovak Republics dismantled the foundations of the command system through deregulating businesses, liberalizing prices, imposing restrictive fiscal and monetary policies, introducing currency convertibility on the current account and trade liberalization, and the incipient privatization. The second stage of transformation is aimed at developing the policy framework and economic structures required for accession to the European Union. The ultimate objective of this stage is a full integration into Europe of countries that historically were inherently tied to the all-European social and economic system.

This paper identifies essential policy changes for the preparation for accession of the four Central European (CE) countries to the European Union (EU), emphasizing problems of unemployment and socio-economic protection. Select monetary and fiscal policy preparations for admission to the EU have been addressed elsewhere (Orlowski 1995), as have more general economic policy prerequisites (Commission of the European Communities 1995). The underlying hypothesis is that the candidate countries' governments will establish unemployment-reducing policies and other social welfare schemes in the course of preparations for the entry to the EU. At the center of this discussion is the belief that assistance for employment-fostering policies leading to the future improvement in the quality of labor in CE is more efficient and desirable than the future income transfers covering unemployment benefits and social safety that would have to be otherwise provided. Because the Union's legal framework is not fully compatible with the laws of CE countries, at least in terms of the common agricultural policy, welfare systems, and labor protection laws, closing this mismatch will affect unemployment and the relative availability of income transfers. Unable to rely on outsiders as a predominant source of such transfers, CE economies must continue policies leading to high internal savings. This can be accomplished through sustained balancing of government budgets and through restrictive monetary policies generating positive real interest rates and diminishing inflation.

Essential requirements of economic stabilization policies in the process of preparation for accession to the EU are examined by section I of this paper. Section II identifies the social groups in CE countries most vulnerable to bear costs of the necessary economic adjustments. The problem of rising unemployment is exposed in section III. The concluding section IV presents some obstacles to the implementation of social welfare and employment-fostering programs.

I. Stabilization Policy Requirements for Accession to the European Union

In order to diminish the need for future income transfers facilitating the integration of CE with the EU, the CE states must develop fast growing, low-inflation economies. General conditions for accession to the EU of the six Central European countries that by mid-1995 have signed association agreements with the EU (Poland, Hungary, the Czech and Slovak Republics, Bulgaria and Romania) and those negotiating similar agreements (the Baltic States and Slovenia) are incorporated in the European Commission 1995 "White Paper" (Commission of European Communities 1995). Only a stable economic environment is attractive for direct capital investment and suitable for developing a competitive partnership with the rest of Europe. Establishing an economic stability of the CE systems appears to be a long-term process that, perhaps with the exception of the Czech Republic, has not produced fully satisfactory results yet (Balcerowicz and Gelb 1994). Table 1 compiles stabilization policy measures for Poland, Hungary, and the Czech and Slovak Republics also known as the Visegrad Group (or V-4) states after the 1991 Cooperation Agreement signed in the Hungarian city of Visegrad.

It is difficult to evaluate the annual rate of real GDP growth for the rest of the 1990s of the CE countries necessary for catching up with the level of development of the EU.(1) The 1994 estimated growth rates for the V-4 countries presented in Table 1 are somewhat encouraging considering the fact that the first phase of the economic reform has generated rather deep negative income shocks in ail four economies. These shocks are primarily attributed to the collapse of trade within the former Soviet Bloc, cuts in subsidies to inefficient producers, and to closings of obsolete enterprises. Positive GDP growth rates reported for Poland, Hungary, and the Czech Republic in 1994, despite the remnants of the EU recession and growing trade deficits with the EU, signal rebounding economies and their successful adjustment to new, competitive structures. Poland is expected to be the fastest-growing economy, due to the brisk 13.2% increase in industrial production in 1994. By contrast, GDP growth in the Czech Republic has been propelled by the rapid service sector expansion. Slovakia, whose income has been negatively affected by the discontinuation of fiscal and implicit transfers from the Czech provinces of the former Czechoslovakia (Burda 1993) shows clear signs of a rebounding economy in 1994. Among the CE economies, only Poland is expected to outperform the EU in terms of the 1994 GDP growth rate. The beginning of the EU economic rebound in 1994 will very likely have a positive impact on the growth of the CE countries' exports and, consequently, on their GDP growth and unemployment rates.

To ensure sustained economic growth, CE economies ought to generate high positive saving rates. For this purpose they need to maintain positive real interest rates and, at the same time, a minimum absorption of saving by the public sector accomplished through a successful control over budget deficits. Restrictive monetary and fiscal policies satisfy these requirements. Table 1 presents the current state of the fiscal convergence (reflected by the budget deficit-to-GDP ratio) and the monetary convergence (measured by the CPI inflation). Needless to say, the Maastricht Treaty guidelines for the candidates for the single European currency system cannot be unconditionally applied to the CE candidates for admission to the EU. The requirement of inflation not exceeding 1.5% above the average of the lowest three inflation rates of the member states be satisfied by the CE states, including the Czech Republic which, for several years, generated a very low inflation and a fiscal surplus until 1994. Rather, a benchmark of CPI inflation not exceeding 10% by the end of the decade is more reasonable (Gros 1996). Nevertheless, the EU admission process shall not allow CE governments to ease up monetary and fiscal policies. Relaxation of the monetary constraint for the purpose of a continued low-interest financing of state-owned enterprises (SOEs) and direct fiscal subsidies to these enterprises slow down structural adjustment and the development of economic structures compatible with the EU economies. The persistent 32% inflation in Poland contains too much inflation inertia related to high inflation expectations incorporated in firms' pricing policies and in wage demands by workers (Orlowski 1994). These expectations stem directly from a low credibility of the government economic policy.

The fiscal convergence in the CE countries is more successfully controlled and shows a promising trend to fulfill the Maastricht requirement of the budget deficit-to-GDP ratio not exceeding 3%. Only Hungary had the budget deficit-to-GDP ratio exceeding the average EU level at the end of 1994. To sustain tight control over fiscal policies in the presence of wage hikes in public enterprises and expanding welfare transfers may prove problematic in the future, however. A strong commitment to preparations for integration with the EU may block accelerating demand by SOEs for government subsidies. However, the recent governments in Poland and in Hungary maintained the level of subsidies and granted wage increases indexed to inflation.

Reduction in the budget deficit-to-GDP ratio combined with the real GDP growth leads to a lower ratio of public debt-to-GDP. The Maastricht Treaty criterion of having less than a 60% ratio of debt-to-GDP for candidates for a single European currency shall be extended to the CE economies. Attaining this benchmark will be challenging for Poland whose 1994 ratio was 77.7%, although the economic strategy for Poland recently prepared under the auspices of the Finance Minister Gregorz Kolodko assumes that the 60% level ought to be reached by the year 2004 (A Strategy for Poland 1994). This task will be equally challenging for the Czech and Slovak Republics reporting the ratio of 69% in 1993 (World Bank: World Debt Tables 1994/95). Hungary, whose ratio in 1993 was only 47%, is expected to add quickly to its size unless the country's growing fiscal deficit is reduced.

In preparation for accession to the EU, the candidate countries must accept foreign competition and a new international division of labor (Gros and Steinherr 1991). A uniform tariff on imports and the elimination of barriers to trade with the EU partners will very likely induce intensified imports from the EU and CE countries to each of the CE economies. These imports will include heavily subsidized EU products. Such a trade diversion may cause an excess demand for foreign goods to emerge. CE consumers are likely to substitute higher-quality western products. Further-deepening CE trade deficits which, under the presence of limited foreign exchange reserves, will have to be financed by borrowing from abroad or by a surplus in the transborder, unregistered trade.(2)

Preparation for unification with the EU system also will require substantial changes in monetary policy targeting and implementation. Under the new circumstances, exchange rates will have to emerge as the monetary policy target, replacing the presently applied control of money supply and low inflation as the policy benchmarks during the first stage of the economic transformation (Orlowski 1995). The candidate countries' currencies will have to be closer aligned with the ECU and the DM to ensure a better coordination of stabilization policies in the unified system. In order to establish such a coordinated system, CE governments must be able to control monetary and fiscal policies more effectively and to significantly reduce inflation which always reflects symptoms of instability in economic systems. Furthermore, competitive domestic equity and debt markets must be further developed in order to improve the monetary policy effectiveness. A large-scale privatization leading to equity trading in secondary markets and securitization of government deficits ought to be enhanced in order to develop competitive financial markets. At the same time, inflation must be lowered to a single-digit targeted range in order to attract public interest in equity and fixed-income investing. These are essential preliminary developments of the financial sector for accession to the EU. However, the control of exchange rates as the new monetary policy target cannot come too early during the economic transformation. Money supply and low inflation must continue serving as official targets until a stable economic environment is developed. The policy orientation on domestic targets rather than on exchange rates helps to establish a system of sheltering the CE economies from currency shocks that are likely to occur in the EU and a stable domestic economy is essential for stimulating investment necessary for a continuous structural adjustment. A steady economic growth, free of inflation expectations and of excessive wage demands is a necessary condition for a fast-track implementation of privatization programs and structural reforms.

II. A New Framework for Social Safety Nets

Significant changes in the social security system in CE economies took place during the first stage of the economic transformation (International Monetary Fund: World Economic Outlook 1994, Kopits 1992, Pestoff 1995).

Preparation for accession to the EU will require a further changes in order to match the CE social safety nets with the well-developed social security system of the EU.

The social safety system under central planning provided a guaranteed employment in SOEs, as well as housing, health care, vacation in company resorts, and education provided by SOEs or by the state (Roxin and Hoos 1995). With increasing financial independence, enterprises have discontinued many of these benefits. Provision of these services by the government or by specialized private agencies (pension funds, travel companies, private schools, private health care, and so forth) is growing. This change has a dramatic scope and it can only be accomplished through a long-range national strategy addressing social services and protection indispensable during the economic transformation.(3)

Adjustment of Central European social safety nets are hampered by the lack of uniform social policy standards in the EU. In particular, EU member states have not been able to harmonize social security schemes although they have made efforts to coordinate national laws (sick leave, maternity, invalidity, old-age and survivor's pensions, work accidents and occupational diseases, unemployment and family benefits) throughout the community. The EU Commission has established four principles of social security systems (Commission of the European Communities 1995, Annex, p. 71):

1. Application of a single legislation (protecting migrant workers from social security contributions in more than one state).
2. Equality of treatment (granting the migrant workers comparable benefits and subjecting them to equal obligations across the EU).
3. Retention of acquired rights (to pensions and other benefits across the EU).
4. Aggregation of periods of insurance and residence.

A cross-border flow of capital assets of pension funds is a subject of particularly heated and unresolved discussions between the EU members. These assets are estimated to reach $2 billion (U.S.) in 1994 and expected to increase at least four times by the end of the decade. Although the 1957 Treaty of Rome and the European Act of 1985 guarantee freedom of capital flight across Europe, pension funds assets are still subject to strict national controls. These asseets are unevenly developed among the member countries. Pension funds assets reach 82% of GDP in the Netherlands and 75% in the United Kingdom, while a similar share in the remaining EU countries is rather marginal. In addition, they are subject to restrictions on the domestic asset component. For instance, 34% of French pension funds must be invested in the French government securities and Germany requires a minimum of 80% of pension funds to be held in German marks. These obstacles will have to be overcome with preparations for the introduction of a common currency in 1999.

Among the complex social safety issues, pensions may be the most urgent. Rising structural unemployment in the first stage of transformation contributed to an increase in the number of individuals seeking early retirement, as did the aging population--the share of senior citizens in the CE countries' total population is relatively high and steadily increasing. The ratio of people over 60 years of age to the total population in 1992 was the highest in Hungary, 18;9%; lower in the former Czechoslovakia, 17.8%; and the lowest in Poland, 12.9% (United Nations Monthly Bulletin of Statistics).

Correspondingly, Table 2 illustrates the dramatic rise in the dependency ratio measured by the percentage proportion of pensioners to currently employed members of the labor force for the Visegrad Group countries. In the four examined countries the dependency ratios were high in 1992. They have been sharply rising as the transformation proceeds. Some of the increase in the population of pensioners stems from the legislative chaos and the lack of uniform regulations of the pension system at the early stage of transformation. Many individuals simply took advantage of arbitrarily granted high pensions. There were almost no regulations among the region's states in terms of the size of pension benefits, eligibility criteria, contribution base requirements, prevention of simultaneous pension and job incomes, or circumstances qualifying for early retirement. These loopholes provided pressure on higher government spending. For example, the rapid increase in the number of workers retiring early and pensions in Poland was induced by the attractiveness of retirement and pension benefits relative to unemployment benefits. The ratio of the average pension to average earnings in 1992 reached 75% in Poland, while in the former Czechoslovakia it was only 49% and in Hungary 45% (Rexin and Hoose 1995, p. 283), which is a comparable level to the 40-50% ratios of the EU members. The strong propensity to seek pensions resulted also from liberal eligibility criteria, limited supervision over the system and expectations of restrictive pension reforms (Schwartz 1994).

More recently, a series of changes reducing the scope of the extensive loopholes have brought the pension systems closer to the present EU policies. Specifically, Hungary increased minimum contribution periods and Poland reduced the maximum pensions (International Monetary Fund World Economic Outlook 1994, p. 84). Poland regulated eligibility criteria by introducing unified sickness prevention and rehabilitation rules and tightening family allowances and therapy coverage (A Strategy for Poland, 1994). It has also enacted a gradual elimination of entitlements to early retirement and has increased the retirement age for women to 65.(4)

All four states have introduced state-controlled pension funds and have established legal rules for an introduction of private pensions and insurance funds. Specifically, the Czech government favors a pension system which is a combination of a mandatory-based pension insurance, a voluntary additional pension insurance, and private plans (Goetting 1995, p. 372). The Czech and Slovak Republics and Hungary have made efforts to separate the pension funds from the stage budget. Furthermore, retirement-age limits have been recently adjusted to a standard of 65 years of age in Poland and 60 in Hungary for both males and females. The Czech Republic reduced the absolute retirement age to 62 for males and 61 for females in 1994. Despite these steps, it remains necessary to unify regulations for early retirement, and to establish a system of national identification numbers for all employees and employers, along with a full computerization of records (Kopits 1992). Such an integrated system will facilitate mobility of workers within the expanded Europe and the determination of taxes, social security and pension contributions for migrant employees of the European companies.

With the rising number of retiring members of the CE societies, social security expenditures exert additional pressures on budget deficits. A sharp increase in social security expenditures is among the key factors contributing to deficit problems of Poland, Hungary and the Slovak Republic. To illustrate the problem, Table 3 presents the share of social security expenditures in total government spending and the share of social security receipts in government revenues. Only in the case of the Czech Republic the share of social security in government revenues is greater than in government spending, contributing to a self-financing character of the social security system. By contrast, a large gap between the share of social security in government revenues and a much larger share of social security in government spending exists in Poland generating pressures on the budget deficit. As the deficit is still financed primarily by the accommodative monetary policy, this gap significantly contributes to high inflation. A comprehensive reform of social security systems is an urgent task for Poland, Hungary and Slovakia to develop self-financing of social security funds and to relax pressures on the deficit. Emerging private retirement and pension funds and insurance companies will ease the burden of the growing population of retired members of societies on the government budget.

Another symptom of the collapse of state patronage over social safety is growing poverty. This phenomenon does not normally occur in a society where the level of general education is very high-that is, where the average number of years of education of those in the labor force is well above that of middle-income economies of the world. Systemic transformation contributes to structural unemployment and thus to an increase in the number of poor. There is no uniform definition of poverty among the Visegrad Group countries. Specifically, the Czech Republic determines the poverty level using a relative method at 50% of average income per capita. Hungary uses both relative and normative (based on the assessment of "vital needs") measures of a minimum standard of living determined annually by the Parliament (Roxin and Hoos 1995, p. 312). Poland applies a normative definition of poverty. According to the IMF estimate, a third of the population is living in poverty in the transforming economies of Central and Eastern Europe (International Monetary Fund World Economic Outlook, 1994, p. 87). A better picture of the poverty level is provided by comparisons of the ratio of spending on food in total personal consumption reported n 1992 in the range between 24% in Hungary, 33% in the former Czechoslovakia, and the highest, 39% in

Poland (Golinowska and Ochocki 1994, Toxin and Hoos 1995). These levels are much higher than in the economies of the EU. It shall be, however, noted that the high share of food consumption also results from the remnants of the structure of consumer spending that prevailed under central planning. In the past system, spending on housing rentals, education, health care, or vacation was minimal since these areas were heavily subsidized by the state. Consequently, the share of spending on food was considerably higher.

Nevertheless, poverty is becoming a major concern of policymakers and with the growing number of the poor, the demand for government income transfers is sharply rising. To reflect the increasing burden of income transfers for CE economies, Table 4 presents the ratios of transfer payments-to-nominal GDP on the eve of the economic transformation in 1989 and in 1992.

In all four economies, transfer payments in proportion to GDP have increased significantly. Hungary and Slovakia report the highest levels. Although Poland's transfers were the lowest in relation to the GDP, their increase in the three-year period was the steepest. The ratio is expected to climb even further within the next several years (A Strategy for Poland, 1994).

The strong public demand for income transfers directly results from at least several factors: rising unemployment, expanding poverty, and a sharply deepening inequality of income distribution. Precise income inequality estimates such as the Lorenz Curve data (referring to the percentage of income earned by equal percentile groups of families ranked from the poorest to the wealthiest) or the Gini Coefficient (the proportion of the inequality area to total personal income) in the years concluding the first stage of the economic transformation are yet to be assessed. In spite of that, there is a number of surveys indicating the problem of rising income disparities in CE societies (Kolarska-Bobinska 1994). As evidenced for Poland, during the first four years of the economic transformation relative real incomes of low-skilled workers and farmers fell significantly comparing to incomes of managers, business proprietors and well-educated and skilled workers. Specifically, real incomes of managers increased approximately 2.5 times while real incomes of low-skilled workers marginally declined in the period 1987-1993 (Schwartz 1994, Kolarska-Bobinska 1994).

These social developments are not favorable from the standpoint of preparations for integration with the EU. Rising demand for income transfers will have to be somehow compensated in the future. It is unlikely that the EU will be willing to support the unemployed of Central Europe to the extent Western Germany does for East German provinces. To develop competitive skills of CE workers, large-scale training programs may be required. Such programs ought to be jointly sponsored by CE governments and the EU Commission and implemented by specialized corporate training and academic institutions. Many of them are already in place although there is no system of their evaluation. Perhaps joint EU Commission and CE governments committees could be established in order to develop such a comprehensive system that would enable sponsoring only the qualified and effective training programs. The main criterion of evaluation ought to be the best possible adaptation of the CE workforce to open economy, competitive conditions.

There is a complex relationship between spending priorities on social safety and on human capital development. The tradeoff in the short-run balances government and private sector expenditures on welfare and investment in human capital against high unemployment, increasing poverty, and a high share of retired persons in total population absorbing funds that could be otherwise allocated on labor training programs (Golinowska 1995, p. 134). However, investment in human capital may increase productivity and labor force competitiveness in the long-run. Without sufficient qualifications, CE workers will experience high unemployment and create demand for compensatory benefits that will have to be financed either by limited domestic sources or by external savings.

III. Dealing with Rising Unemployment

The officially reported unemployment rates in CE countries at the end of 1993 are reported in Table 1. Three countries-Poland, Hungary and Slovakia-have unemployment rates exceeding the EU level. These levels can hardly be described as "natural unemployment rates" or "nonaccelerating inflation rates of unemployment" (NAIRU) since they are sustained at high levels despite generally growing incomes and declining rates of inflation. Only the Czech Republic has shown a remarkable record in dealing with unemployment. The country's commendable reduction of unemployment has been accomplished through a successful privatization program, a fast growth of the service sector, and large direct investments from the West, primarily from the Bavarian companies across-the-border investment pouring into a stable economy and high productivity environment. Elsewhere in the region, the implementation of privatization programs and the growth of the service sector have been much slower thus significantly contributing to higher unemployment.

Rising cyclical and structural unemployment in Poland and in Hungary during the first stage of the economic transformation was induced by a declining real GDP until 1992, in combination with structural adjustments driven by the allocative function of changes in relative prices. As systemic changes proceed and the CE economies begin to grow, cyclical unemployment will decline relative to structural unemployment. For example, Polish industry still employs 46.1% of the labor force, agriculture 8.3%, and the service sector 45.6%. This structure lags behind most of the highly developed industrial economies where the service sector plays a dominant role: the service sector hires three-quarters of the total labor force in the United States.

The declining rates of unemployment in Poland, the Czech Republic, and Hungary in 1994 reported in Table 1 are very encouraging. They result mostly from an accelerated rate of economic growth and a rapid expansion of small business formation. Small business accounts for nearly 50% of GDP in these countries. The officially reported unemployment rates for CE shall be interpreted with caution. While unemployment data may be overstated since a number of recipients of unemployment benefits actively work in the emerging small businesses that do not always report incomes to tax authorities due to tax laws and weak collection of taxes, unemployment may be understated because SOEs still prevail as dominant employers in the region. s Traditionally, SOEs overstate contributing to "hidden" unemployment.

Perhaps the most remarkable feature of the CE unemployment is its unbalanced regional distribution, indicating a very low mobility of labor. The provinces of the Czech Republic adjacent to Germany already face a practical shortage of labor, while some of the northern provinces in Poland have unemployment as high as 30% (Koszalin Province). Regional differences in unemployment stem in part from enforcement of bankruptcy laws and simultaneous cuts in direct fiscal transfers to formerly subsidized regions (agriculture and mining, for example). One may wonder about potential changes in the regional distribution of CE unemployment once these countries join the EU and will take advantage of the EU openness to migrant workers.

The CE unemployment is also characterized by a high percentage of young people without jobs. In Poland, 33% of those unemployed are between 15-24 years old. This is particularly painful because it is still rather difficult for college and high school graduates to find jobs and this discomfort discourages them from pursuing education.

The slow progress of privatization, especially in Hungary and in Poland, contributes to the duration of structural unemployment. In the case of Poland, over 45% of the unemployed are without jobs for over a one-year period, and 55% have lost the right to unemployment benefits. These are symptoms of an expanding "chronic" unemployment (A Strategy for Poland, 1994). The number of long-term unemployed in 1992 and 1993 was rising faster than the overall unemployment which implies the existence of an extensive structural unemployment (Hausner et al. 1995, p. 227).

The Visegrad Group countries have introduced new legal rules for unemployment policies since 1991. Among them are rather standard conditions for eligibility of unemployment benefits such as the age of applicants between 16 and the retirement or pension age, a waiting period between 14 and 30 days for the unemployment registration, and a physical ability of job-seekers. In addition, some countries attach special conditions for unemployment benefits. Specifically, Poland introduced the obligation to accept job offers consistent with the applicant's training and education, and the exclusion of land owners. Unemployment programs are financed by public and private sources in these countries. The duration of benefits varied in the beginning of 1994 between 6 months in the Czech and Slovak Republics, 6 to 12 months in Hungary, and 12 months in Poland. The Czech Republic has a generous system of retraining grants and social and for an unlimited period after the expiration of unemployment benefits. Social aid is also available in Hungary, while Poland provides retraining grants but generally no social aid (Roxin and Hoos 1995, pp. 298-230).

The complexity of reasons underlying the CE unemployment and its diversity require a more detailed empirical investigation aimed at designing appropriate preventive policies. A survey identifying the factors contributing to unemployment and proposing methods preventing its expansion is reported by Witkowski (1994). The results of the survey, presented by Table 5, summarize an opinion poll conducted among the large group of the unemployed in different parts of Poland. These results should be interpreted with caution since both the reasons for unemployment and the preventive methods are assessed by the unemployed themselves, many of whom may be members of the former socialist bureaucracy or workers whose skills are not needed in a competitive economy.
The survey implies that the overwhelming majority of the unemployed attribute the loss of jobs to the government economic policy. It proves that the society still awaits the government to actively support businesses and to provide jobs. During the first stage of the economic transformation, CE reformers introduced anti-inflationary policies based on the tight control over government spending and over money supply. These policies were designed to improve the economic efficiency of enterprises. Their unavoidable cost was the reduction of the excess employment beyond the efficient level, that is, layoffs of those whose marginal contribution to revenues was smaller than wage rates. Consequently, a large number of the least qualified workers lost their jobs. The sentiment of the unemployed favoring job security provided by the former socialist system is consistent with a large proportion of the surveyed attributing unemployment to "capitalism," to "transformation," and to "privatization." Among other factors, mismanagement of enterprises is also emphasized. Most of the SOEs still have managers who have been either appointed through the socialist "nomenklatura," or simply accustomed to managerial techniques suitable for conditions of the "soft budget constraint" situation, that is, readily available subsidies to SOEs covering their inefficiency. Survey results seem to emphasize the need for a better preparation of managers, yet the survey ranks the need for workers training relatively low, perhaps, reflecting pessimism of the unemployed with finding jobs through improvements in their qualifications.
Survey results identifying methods for reducing unemployment. By far, the most important aspect is an appropriate climate for creation and development of new businesses. Not surprisingly, the first years of the economic transformation in all countries of CE were characterized by a strong growth of new businesses accompanied, however, by a large number of business failures. There have been too many mistakes made on this ground. Inexperienced businessmen in many cases opened their shops and production facilities in wrong areas where the growing competition quickly corrected their ambitions. The new entrepreneurs often lacked skills in marketing and in product pricing, seldom offering their products for sale. They also did not know how to set prices in a high inflation environment. Governments shall also be blamed for too many business failures. Seeking maximization of tax revenues, they often did, and still do, tax small companies excessively, especially the honest ones which pay taxes. At the same time the tax enforcement among firms evading tax payments is still insufficient.
The government creation of public work is ranked relatively high in the survey. It is a desirable method of reducing unemployment in the process of preparations for accession to the EU. In order to improve trade and to promote private investment, the infrastructure in CE must be upgraded. The ongoing highway and telecommunication projects co-financed by the European Investment Bank are perhaps the best kind of economic assistance the EU can provide for the CE nations at this time.
Whatever the merits of the survey of the unemployed are, it provides a useful material for designing future policies to foster employment. There are additional factors that might help to create jobs in CE countries. A critical role among them is played by a formation of regional economic policies aimed at alleviating territorial disproportions in unemployment. Economic authorities in CE countries shall consider enacting laws and programs that will stimulate a higher mobility of labor. Special economic zones in high unemployment areas or in the regions well-endowed in tangible capital would also diminish such disproportions. Investment areas of comparative advantage of CE in the expanded EU framework due to a larger gap in labor costs than in productivity of labor between CE and the EU.
The quality of labor shall also be improved. Governments assisted by the EU Commission ought to further intensify

training of CE entrepreneurs and workers, provide discretionary credits for creation of small businesses and financial incentives to hire young graduates of universities and technical schools. Grants for training and retraining programs at educational institutions will be useful for educating people ready to meet challenges of global competition. Many of these activities have already been in place but the programs for preparation for unification with the EU create an extraordinary opportunity to launch ambitious policies aimed at improving the quality of labor in CE. These inter-governmental programs require long-range planning and implementation.

Changes in the financial system can be relatively quickly introduced to facilitate active employment policies: cuts in capital consumption allowances (depreciation rates) and cuts in business profit taxes, for example. For the same purpose, restrictions in unemployment benefits ought to be considered in order to make them less financially attractive than wages or small proprietors' profits. The opportunity cost of employment (in terms of benefits from unemployment) cannot be too high so that people are not discouraged to work. Moreover, a better nationwide cumputerized information systems about job opportunities and advanced job-searching techniques are among the new employment-fostering methods not previously known or needed under central planning, yet essential in a competitive global economy.

In essence, the opportunities in terms of employment-fostering policies in CE are immense. Programs of preparations for accession to the EU ought to pay a special attention to these policies and, generally, to investment in human capital. This approach is certainly more effective than direct transfers that would have to be otherwise provided to subsidize unemployment and social safety in the CE countries based on the EU standards once these countries enter the EU system.

IV. Conclusion: Potential Difficulties in Social Policy Implementation

Preparation for accession to the EU will require, Visegrad Group countries to reform their social safety nets. Unemployment criteria and benefits, and regulations of pensions and retirement funds will have to undergo adjustments aimed at encouraging people to work. High benefits shall be perceived as high opportunity costs of employment, discouraging people from working and motivating them to seek transfer payments instead. Consequently, assistance for employment-fostering programs leading to the improvement in the quality of labor in CE shall be viewed as more efficient and desirable than current and future income transfers covering unemployment benefits that would have to be otherwise provided.

Given limited EU social safety standards and rules, the Visegrad Group countries have no clear direction for legislative adjustments. A sustained economic growth accompanied by a reduction in fiscal deficit and by a low rate of inflation are the most critical conditions for job creating and for declining unemployment. A new job formation will reduce demand for transfer payments and, consequently, will allow to allocate more public and private funds to investment in human capital. It would be otherwise very risky for CE workers to enter a highly competitive EU labor market without an improvement in quality and productivity of labor. If the candidate countries' labor force is unprepared to compete in the EU-wide labor market, their unemployment will eventually rise.

The construction of social safety and employment-fostering programs in the process of preparations for accession to the EU is not an easy task. The ultimate goal of such programs will be to improve the efficiency and skills of CE labor and, at the same time, to establish reasonable social safety nets. In the future, the CE workers will be confronted with their efficient and highly skilled partners in the West. The future CE labor force will have to be creative and entrepreneurial, it will no longer enjoy the state protection and subsidies to the extent they used to be granted under central planning. The unification with the EU will bring new challenges to the CE labor which are not comfortable to these interest groups that enjoyed a privileged position in the command economy system. These groups are likely to put pressures on governments in CE to soften labor and social reform programs and to grant excessive income transfers.

In addition to these political dangers, the programs of reasonable safety nets and job creation may be jeopardized by the economic instability, particularly by a continuously high inflation. Unanticipated price increases normally lead to a slowdown in business investment, both from domestic and foreign sources which, in turn, may prolong high unemployment. Similarly damaging to these programs are delays with privatization caused by slow legislative efforts in Poland and in Hungary, or by fears of workers and managers to undergo privatization which may cause job loss.

Notes

1. For example, Sachs (1993) states that Poland should generate a 7% annual real GDP growth rate to the end of the 1990s to develop conditions allow it to enter the EU.

2. As a solution to surging trade deficits in transforming economies of CE, some economists suggest temporary high tariffs (Gros and Steinherr 1991, Corden 1992). However, this "second-best" solution to the excess demand for foreign goods is not desirable at the time of implementation of the General Agreement on Tariff and Trade/World Trade Organization Uruguay Round tariff reductions and at the time of allowing free market forces to identify the areas of comparative advantage in the undistorted way.

3. An example of a national economic strategy extensively addressing social protection and job creation is "A Strategy for Poland" (1994).

4. However, the Polish Ministry of Labor proposed in May 1995 a change of indexation rules for pensions. Current pensions and retirement funds formulae are composed of weighted valued of three elements, average wage before retirement, individual contribution over the past ten years, and compensation over noncontribution periods (such as a maternity leave). The proposal increases the share of the first component which is financed by the government, diminishes the share of the second, and entirely eliminates the third. This is a step backward from the standpoint of balancing the budget deficit and rationalizing the structure of government spending since the publicly financed retirement funds will require budgetary subsidies which size will not be sustainable in the future. In addition. this component of retirement funds will be subject to price indexation making the real value of government spending on retirement programs impossible to cut.

5. The low reliability of unemployment data stems also from the differences in the methodology of data collection applied by national statistical agencies and by labor offices. The statistical agencies' estimates are generally more reliable than surveys used by labor offices.

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