

Analyzing the Labour Market Situation in the Central and Eastern European Countries – Improvement or Decline?

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SUMMARY

This paper presents the labour market situation, in particular the employment and unemployment trends in the Central and Eastern European (CEE) countries that joined the European Union in 2004 (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia). A general feature of the ex-socialist countries of the region is that they inherited a relatively developed non-market sector from the era of state-owned economy. My hypothesis states that the labour market position of the CEE transitional countries differs in terms of employment rates. According to my hypothesis, the economic revitalizing effects of the employment policy cannot be experienced so strongly in the underdeveloped regions and only temporary results can be achieved in the social area, because of the short-term focus. Economic and social reforms in the Central-Eastern European economies have induced important output changes since 1989 (the end of the socialist regime). It is often said that open unemployment was unknown in socialism and the employment rate was very high; each worker considered his or her job to be secure. Rather, an inverse disequilibrium was typical. The socialist economy resulted in chronic shortages, one manifestation of which was – at least in the relatively more developed and industrialised CEE countries – chronic unemployment. This paper focuses on the major forms of labour market indicators and examines their significance in the Central and Eastern European transitional countries.

The three research questions the paper attempts to answer are:

Is there divergence or convergence between the CEE countries in the prevalence of the labour market situation?

What are the differences between the major labour trends in these countries?

Is Okun's law valid in these countries?

Keywords: transition economies, labour market, world economic crisis, Okun's law

Journal of Economic Literature (JEL) code: J21, R23

INTRODUCTION

I have chosen as the focus of my research the analysis of the labour market situation, particularly in transition economies, over the last twenty years and the world economic crisis (from 2008) because it has been more and more used in the economy and can be considered a current question. A general feature of the ex-socialist countries of the Central and Eastern European (CEE) (the group of these countries is called, somewhat imprecisely in geographical terms) region is that they inherited a relatively developed non-market sector from the era of state-owned economy. This paper focuses on the actual situation of labour market relations and examines their significance in the CEE countries. The three research questions the article attempts to answer are: (1) Is there divergence or convergence between the CEE countries' labour market situation? (2) What are the differences between employment rates in the CEE countries according to the statistical data since 2004? (3) How has the unemployment rate changed due to the world economic crisis?

FEATURES OF THE TRANSITION ECONOMIES

“A transition economy is an economy in the 21st century which is changing from a centrally planned economy to a free market economy. Transition economies undergo economic liberalization, where market forces set prices rather than a central planning organization and trade barriers are removed, privatization of government-owned enterprises and resources, and the creation of a financial sector to facilitate the movement of private capital.” (www.economies-dictionary.com).

The countries of the world can be classified according to various aspects; however, the categories set up by the UN are the best known: landlocked developing countries, least developed countries, heavily indebted poor countries, newly industrialized economies, emerging economies, major petroleum exporters, major exporters of manufactured goods, developed economies, economies in transition, and developing

economies. The current classification of CEE countries is not evident: some refer to them as countries of transitional economy while the UN considers them to be developed.

The term “transition” is widely used in relation to the change of the economic arrangement of the ex-socialist nations, with special regard to the Central and Eastern European countries. However, the transition from what to what is often blurred. Each of the ex-socialist countries was denied private property and the free market. At the same time, these countries regarded improving economic growth and living conditions of the society as central objectives. Accordingly, the free market was replaced by a bureaucratic institutional system which is usually called “central planning” or a “command economy”. When talking about the transition of these countries we cannot assume at all that it is a homogeneous process. What is unquestionably common among the countries is that the coordinative role of the state authorities weakened or vanished almost simultaneously. The market coordination, however, was unable to take its role from one day to another. (Hüttle et al., 1998)

Hungary and the CEE countries found themselves in an unfavourable economic/social situation after the change of regime (1989). The total economic policy changed, similarly to other post-socialist countries; prices and the demand-supply relation changed. The market competition became more intense and complex with the changing economic institutional system and changing laws.

We could see not only that the intensity and complexity of the market competition grew parallel with the development of the institutional system, and that the mobility of the capital increased and fundamental changes took place compared to the centrally planned economy, but also that such a peculiar market environment of the free-enterprise economic system was formed in which the competition turns against itself (Bara, 1999).

One of the working processes of the market economy is market competition; establishing its conditions was an important economic policy task in the transitional period after the centrally planned economy. The research analysing the comprehensive changes in the CEE countries' labour market after 1989 represents two main directions. One of the two mainstream economic views is the approach that builds upon the neoclassical micro-economic models, while the other one is the comparative or political economy perspective. The mainstream researchers base their models on the paradigms of the neoclassical theory, using econometric methods. The publications of mainstream researchers first surveyed the employment and wages of the initial phase of the transformation. The modern methodology made it possible to explore the interrelating change of gender, age, schooling and wages of the workforce. The other perspective of research also rests on economic foundations, although it does not apply econometric methods. Its practice is characterised by verbal reasoning and logical demonstration (Polónyi and Timár 2004). In my study I am using the econometric-statistical methods of mainstream economics.

The change of regime brought about radical changes not only in the social reality but also in the social sciences. The post-socialist transformation, on the one hand, changed the

status of research concerning socialism, and, on the other hand, it created a new subject matter for researchers dealing with contemporary matters. “The Copernical turn of economics, in which the classical economics was replaced by neoclassical economics, also restructured the area of focus of economics. The mainstream economics, dissecting the issues of economic equilibrium and perfect competition, gave up examining social changes, although it was one of the central problems of the classical political economy” (Gedeon 1997: 59). The collapse of the social regimes eliminated the traditional subject of the comparative theory of economic systems; the post-socialist transformation created a new area for economic analysis.

Countries having undergone the change of regime chose different paths, and their ways of switching to capitalism were also different since the external environmental factors differed from country to country.

While the harbinger of the regime change could be felt in Poland as early as in the '80s, one can speak of this process only after 1992 in the ex-member states of the Soviet Union. In fact, the Polish regime change began when, as a result of the wave of national strikes in August 1980, the party leadership was forced to negotiate with workers and come to a compromise with them. The Gdansk agreement forced the Polish United Workers' Party to give concessions: the Independent Self-governing Trade Union “Solidarity” could be established. It was the first legal opposition movement in Eastern Europe, and had 10 million members in a short period of time. Solidarity developed into an immense social movement against the central government. The organisation put forward claims associated with wage and social affairs; however, it soon became clear that solving the supply problems was impossible without deep economic reforms. Solidarity soon began to claim the right of controlling production and distribution. They saw the guarantee for the restoration of the market equilibrium in corporate self-governance based on self-governing works councils, against the centralised economy. The decentralisation of the economy, transforming the state-owned property into public property, was a power-political issue, which was clear to the party leadership as well. Solidarity demanded free elections as early as 1981, since it was clear to them that no real economic reform was possible without demolishing the political barriers. The state of war introduced in 1981 put an end to the democratic efforts. Meanwhile, even the promised economic reform did not happen, because the increase of the separateness of companies, the liberalisation of the private sector in the small-scale industry and supporting the agriculture was diametrically opposed to the practice of the state of war. Basically, only a drastic price increase was implemented on 1st January 1982 when the average prices of foodstuff increased by 241% and the prices of energy and fuel increased by 171%. The official data indicate that the real income dropped by 32% in just one year. Finally, the obstacles to the transformation to free market were eliminated in 1989.

The three Baltic states regained their independence in 1990-91, after five decades of Soviet domination. Lithuania, preceding the two other countries, had already proclaimed its independence in March 1990. As part of the Soviet bloc, the Baltic republics were the most reform-oriented, which was

symbolised by the fact that when the reforms began at the end of the 1980s, the Lithuanian, already operating, the economy had been an example to follow. The mass migration entailed by Soviet industrialisation considerably reshaped the ethnic make-up of the population. Mainly Latvia suffered from the colonisation of Russian industrial workers, which is well illustrated by 60% of the population of Riga being not of Latvian origin; their proportion is 40% within the total population. Estonia and Latvia were aware of all these; therefore, having introduced their own national currency, they applied a strict monetary policy. Providing a loan by the central bank via enhancing the quantity of money in circulation in order to finance the budget deficit was strictly prohibited by the Estonian central bank law. Effective monetary and exchange-rate policies are not sufficient for establishing stability without a consequent financial policy. All three Baltic countries adopted strict financial policies, although to various extents, which brought about the drastic decrease of budget deficits soaring at the beginning of the '90s. The extent of the state distribution was 40% to 50% of GDP at the beginning of the transition. Estonia, applying a consequent liberal policy also in the area of budgetary restrictions, was in a leading position, being two years ahead of Latvia and Lithuania. All kinds of price subventions were eliminated in Estonia, whereas subsidies were radically decreased in Latvia and Lithuania, which mainly affected agriculture in the short run. The Estonian restrictions had led to spectacular results compared to the other two countries not predominantly because of their extent, but because they connected the restrictions with institutional reforms (law of competition, law of privatisation, setting up a securities supervision). The three Baltic countries adopted different approaches to the privatisation of state enterprises. Estonia, where almost all the state owned small and medium companies had been privatised by 1995, proved to be the most successful in this area as well. The Latvian privatisation was similar to the Estonian one in many respects; however, the pace of the transformation was much slower. At the beginning strict protocols were in place for restricting the properties to be privatised. Purchasing was exclusively possible for cash and only for those who had been living in Latvia for at least 16 years.

The political revolution in Czechoslovakia started with protests beginning on 17 November 1989. A legal commemorative demonstration began then, a so-called smooth revolution. By the end of November the Czechoslovakian Communist Party had lost its power. Many processes were launched in the first months of 1990 that served the economic and social transformation of the country, but which tragically influenced the relationship between the Czech Republic and Slovakia. The most considerable ones: cutting back the production of heavy weapons, which mainly affected Slovakia (where unemployment became 12% by 1991, whereas it was 5% in the Czech Republic), and the transformation of agriculture and the removal of agricultural subsidies. An important step in dismantling the old structure was legislation relating to the political parties, the freedom of assembly, and the right to vote, as well as several individual and civil rights. Laws

ensuring radical economic reforms were prepared and accepted at a fast pace by the parliament in the summer of 1990. The popular title of the reform was “shock therapy” and “belt-tightening”, the effects of which were felt more quickly and more radically by the Slovak part of the country than the Czech one. The characteristics of the reform included a restrictive monetary policy, the privatisation of state properties (that is, small and large privatisation) and giving back the properties (restitution) confiscated after 25 February, 1948 (during the communist takeover in Czechoslovakia). The economic reform laws entered into force in early 1991, and their effect further spoiled Czech-Slovak relations, already fraught with tensions.

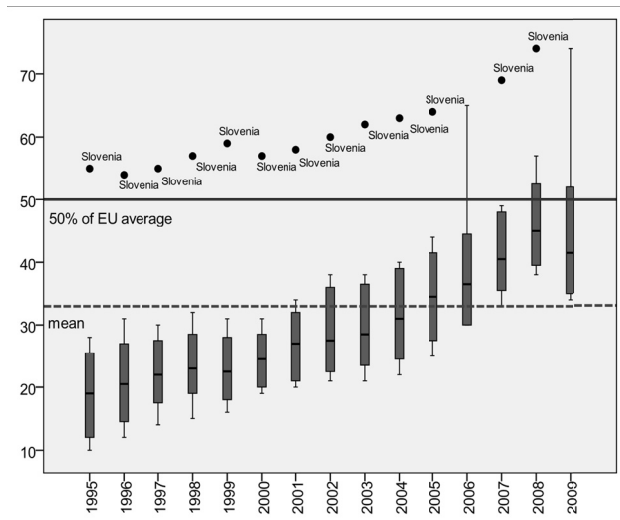
The transformation taking place in the Central and Eastern European countries in the past 20 years can be roughly summarised as follows:

- The changes have taken place in the main directions of Western civilisation's development: the capitalist system in economics and democracy in politics.
- Total transformation was in process in all spheres: in the economy, political structure, political ideology, legal system, and social stratification.
- The transformation was free of violence.
- The process of the transformation took place in peaceful circumstances. It was not preceded by a war. The changes were not forced by a military occupation.
- The transformation took place extremely quickly, in ten to fifteen years.

The capitalist economy, with competition and the market, is not an ideal dreamland. Every system has negative innate system-specific drawbacks: not only socialism but also capitalism. As long as capitalism stays what it is, there will always be unemployment, the inequality of income distribution will always be strong, and there will always be losers of the competition who may drift into financial troubles. A wise, forward-looking and consistent governmental policy can mitigate the innate problems, but cannot totally eliminate them; their revival always threatens.

ANALYSIS OF THE LABOUR MARKET SITUATION IN CEE COUNTRIES

Instead of an overall analysis of the labour market situation I wish to highlight the main segments and provide some necessary information to understand the situation. Before introducing the labour market situation I describe the general economic conditions using the GDP per capita as a percentage of the EU-27 average of the CEE countries. Figure 1 shows the average value and the 50%. We can clearly see that the percentage value of the GDP per capita has been continuously and evenly growing since 1995. Relatively significant growth can be observed in the case of the GDP per capita after the year 2000; Slovenia had outstanding values in each case. Welfare is not uniform in the Eastern Central countries, thus the labour market situation will reflect significant discrepancies in the case of the specific countries.



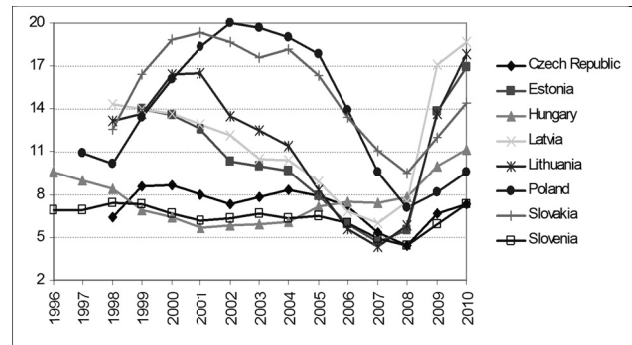
Source: Own compilation on the basis of Eurostat data

Figure 1. GDP per Capita of CEE Countries as a Percentage of the EU-27 Average

Change of Unemployment Over Longer Period of Time

The rate of employment considerably decreased and open unemployment appeared. Its degree differed from country to country; it was lower than the European average in some countries and higher in others. Unemployment practically traumatised the society. Job security was lost. This happened at a time when life had become more uncertain in other dimensions as well.

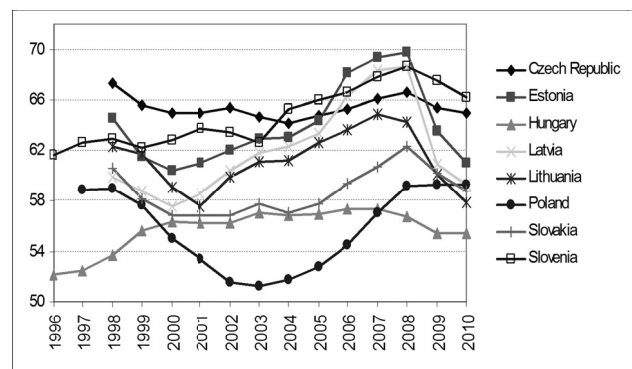
The evolution of the unemployment rate shown in Figure 2 illustrates well the process of the regime change. The most dramatic are the Slovakian and Polish curves, which showed a 15% drawback by the year 2008. The unemployment rate data of Hungary, Slovenia and Czech Republic moved together in each period, although its opposite would have been expected in the light of the GDP figures. Estonia, Latvia and Lithuania travelled along a different route. Their rates of unemployment continuously decreased after the change of regime; they not only completed the regime change quickly and efficiently but were also able to handle the suddenly appearing unemployment efficiently. The economic world crisis commencing in the autumn of 2008 could be instantly felt in the labour market as well; most of the states were unable to get out of the deep recession, although they introduced significant employment policy measures. For example, in Hungary public employment programs became dominant (the Way to Work Program) to treat the problem; however, unfortunately, they did not lead to permanent results. Unemployment struck Latvia the most severely.



Source: Own compilation on the basis of Eurostat data

Figure 2. Unemployment Rate (%) between 1996 and 2010

The regime changing countries in question can be categorised into two groups in terms of the rate of employment (Figure 3): Poland, Slovakia and Hungary possessed lower levels of employment; whereas the rest of the countries moved into higher categories. Studying the Estonian employment policy could be a separate topic; they were able to reach the employment level of 70% as set out by the Lisbon Strategy; however, the crisis struck them as well and it interrupted the trend of rapid growth.

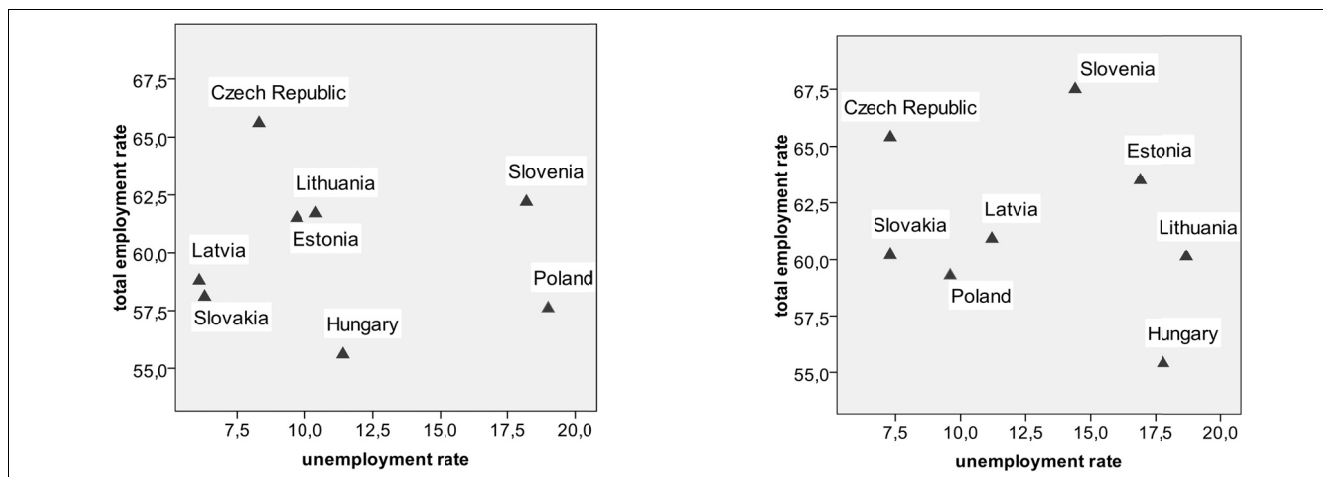


Source: Own compilation on the basis of Eurostat data

Figure 3. Employment Rate (%) Between 1996 and 2010

Positioning of the CEE Countries

By placing the employment and unemployment data in two dimensions, the movement of the countries over the past 10 years is easier to observe (Figure 4). The position of Slovenia and the Czech Republic became stronger by 2010, since their rates of employment had grown and rates of unemployment had decreased. Poland and Slovakia also implemented successful employment policies that put them into a more favourable position. The employment rate was the lowest in the case of Hungary in both periods among the surveyed countries, and the unemployment rate further increased during the 10 years. The most considerable decline could be observed in Latvia, Estonia and Lithuania.



Source: Own compilation on the basis of Eurostat data

Figure 4. Labour Market Position of the CEE Countries in 2004 (left) and 2010 (right)

Hungary had a relatively flexible labour market compared to other East Central countries at the time of the change of regime. After the reforms of 1968 the state influenced the wages paid by companies and the employers could freely choose the level of employment. Changing jobs was not limited by administrative rules, which was reflected in the relatively high level of labour turnover. Further liberalisation took place before

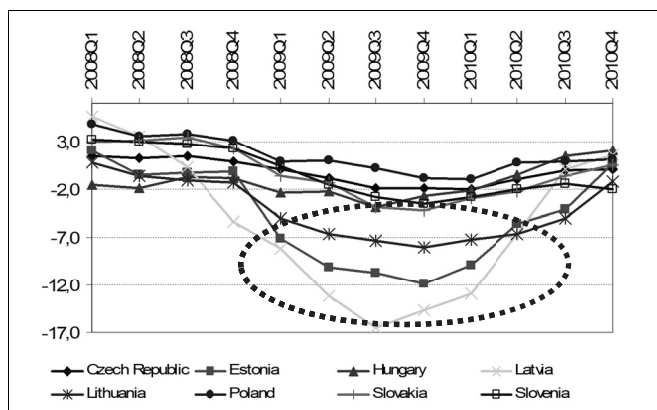
1989: wage regulation gradually eroded, banning mass dismissals decreased and a set of institutions were established that facilitated the life and foundation of enterprises. The inherited administrative barriers were rapidly demolished following the collapse of the socialist regime; however, the period of transition and accessing the European Union created new regulations.

Table 1
Length of Recession in the CEE Countries (% change on previous quarter)

	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3
Czech Republic	1.3	1.0	0.3	0.7	0.2	-0.9	-3.6	-0.5	0.5	0.4	0.6	0.8	1.0
Estonia	0.4	0.4	-2.2	-1.0	-2.6	-5.7	-5.6	-3.7	-1.3	1.4	1.0	1.9	0.7
Hungary	0.3	0.6	1.2	-0.2	-1.0	-2.1	-3.2	-1.3	-0.8	0.1	1.4	0.2	0.6
Latvia	1.9	0.9	-3.0	-1.8	-1.8	-4.0	-11.3	-1.3	-4.2	-0.6	1.0	1.2	0.9
Lithuania	3.4	0.3	1.0	0.4	-1.8	-1.2	-11.5	-2.1	-0.1	-1.1	1.4	1.0	0.3
Poland	1.3	2.2	1.4	0.7	0.8	-0.4	0.4	0.6	0.4	1.4	0.7	1.2	1.3
Slovakia	2.5	5.2	-1.4	1.0	1.2	0.6	-7.6	1.1	1.2	1.4	0.7	0.9	0.9
Slovenia	2.0	0.8	1.7	0.7	0.2	-3.3	-6.0	-0.6	0.4	0.1	-0.1	1.0	0.3

Source: Own compilation on the basis of Employment in Europe 2010 data

The effect of the global economic crisis has been perceptible in Central and Eastern Europe. The length of the crisis is characterized by the increase of per capita GDP by quarters (Table 1). The Baltic countries and Hungary were affected by the crisis for the longest time and to the greatest extent. After the outbreak of the world economic crisis (Figure 5) the Baltic countries were in the worst position, but their employment growth rate increased in the 4th quarter of 2010.



Source: Own compilation on the basis of Eurostat data

Figure 5. Employment Growth Rate (%) and the World Economic Crisis

EXAMINATION OF OKUN'S LAW

In the literature we could read different definitions of Okun's law. According to Sanger and Stiassny the "Okun's law postulates a negative relationship between movements of the unemployment rate and the real gross domestic product (GDP)." (Sanger and Stiassny 2000:3)

"Typically, growth slowdowns coincide with rising unemployment. This negative correlation between GDP growth and unemployment has been named Okun's law, after the economist Arthur Okun who first documented it in the early 1960s." (Knotek 2007:73)

According to Okun's law every 2% rise in GDP compared to the potential GDP causes 1% unemployment growth. Okun noted that the unemployment rate has 1% change in the natural rate of unemployment (NAIRU = non-accelerating inflation rate of unemployment) compared to the output gap by $\beta\%$ change (Okun's coefficient). The output gap is the difference between potential GDP and actual GDP or actual output.

$$\frac{Y - Y^*}{Y^*} = -\beta \times (u - u^*) \quad (1)$$

where:

Y is actual output

Y* is potential output

u is actual unemployment

u* is the natural rate of unemployment

β is Okun's coefficient (a constant derived from regression show the link between deviations from natural output and natural unemployment).

The output gap is the following:

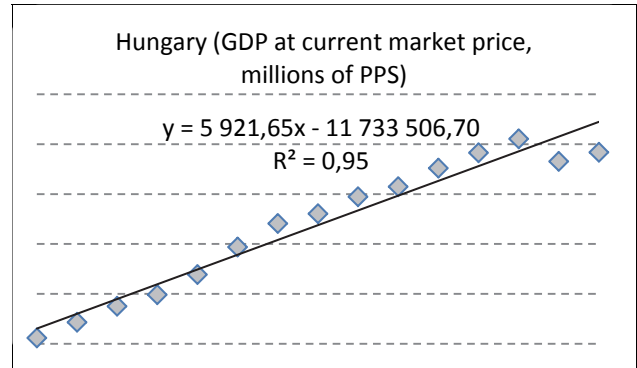
$$x = \frac{Y - Y^*}{Y^*} \quad \text{or} \quad x = [\ln(Y) - \ln(Y^*)] \times 100 \quad (2)$$

where x is the output gap.

Okun's law is

$$x = -\beta \times (u - u^*) \quad (3)$$

When I made the calculation, first I defined the potential GDP with the linear regression equation.



Source: Own construction on the basis of Eurostat data

Figure 6. GDP at Current Market Price in Hungary (1996-2010)

Table 2
Potential GDP and Output Gap

Hungary	GDP (millions of PPS) Y	Potential GDP (millions of PPS) Y*	Output gap (%) x=ln(Y)-ln(Y*)
1996	82 356.9	86 106.7	-4.45
1997	88 586.8	92 028.4	-3.81
1998	95 043.2	97 950.0	-3.01
1999	99 632.8	103 871.7	-4.17
2000	107 761.6	109 793.3	-1.87
2001	118 786.5	115 714.9	2.62
2002	128 189.0	121 636.6	5.25
2003	132 100.9	127 558.3	3.50
2004	138 905.8	133 479.9	3.98
2005	142 927.3	139 401.6	2.50
2006	150 418.6	145 323.2	3.45
2007	156 569.3	151 244.9	3.46
2008	162 115.4	157 166.5	3.10
2009	153 103.1	163 088.2	-6.32
2010	156 769.3	169 009.8	-7.52

Source: Own compilation on the basis of Eurostat data

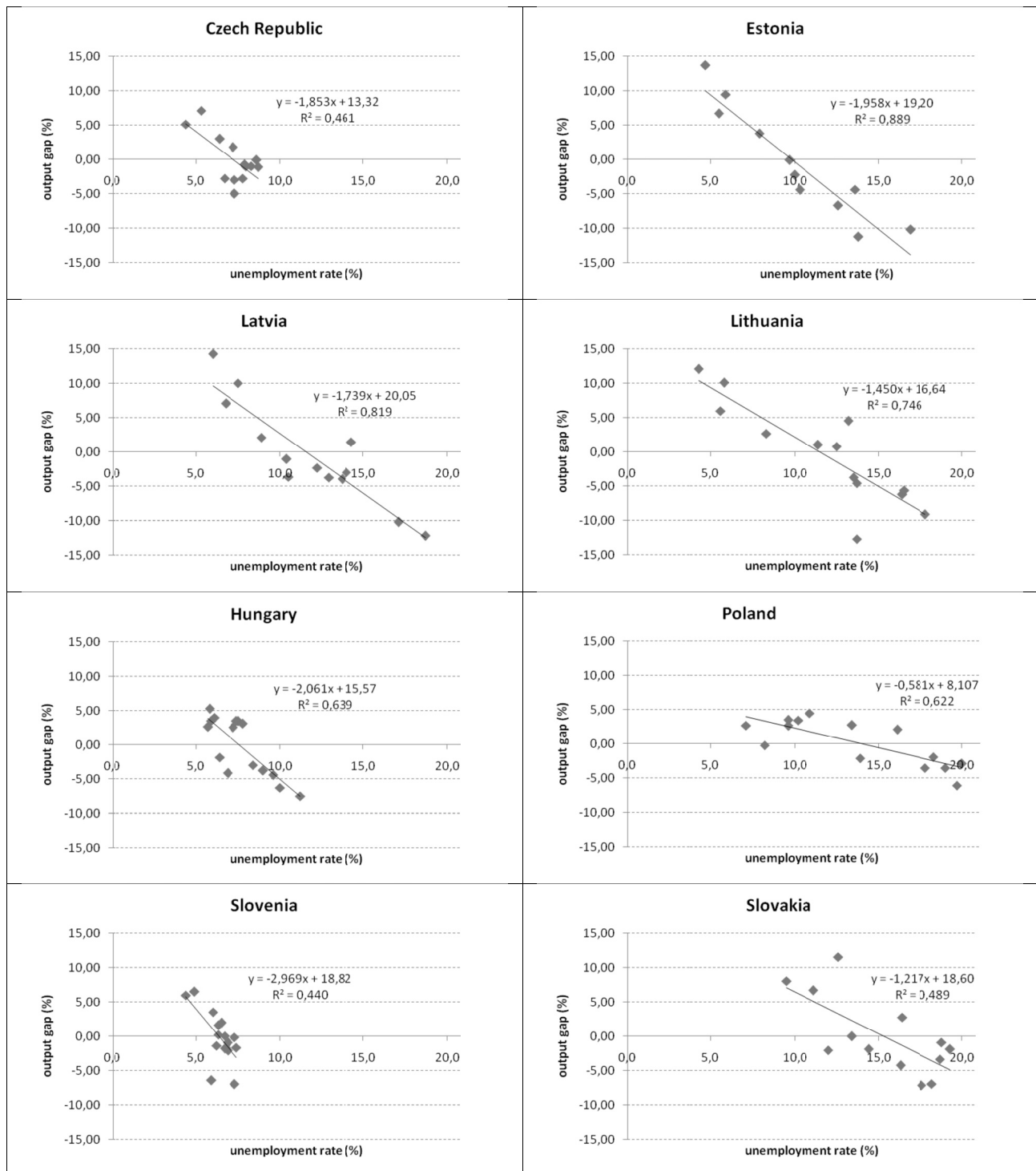
$$Y^* = 5\,921.65 \times 1\,996 - 11\,733\,506.7 = 8\,6106.7$$

Then I calculated the bivariate linear regression model.

Table 3
Okun's Law in the CEE Countries (1996-2010)

	Okun's law	output gap (if the unemployment rate is zero)	natural unemployment rate (if the output gap is zero)	natural unemployment rate (if the output gap is - 2%)
Czech Republic	$x = -1.853u + 13.328$	13.328	7.193	6.113
Estonia	$x = -1.958u + 19.207$	19.207	9.809	10.083
Latvia	$x = -1.740u + 20.057$	20.057	11.527	12.676
Lithuania	$x = -1.451u + 16.646$	16.646	11.472	12.850
Hungary	$x = -2.061u + 15.570$	15.570	7.555	8.525
Poland	$x = -0.582u + 8.107$	8.107	13.930	17.367
Slovenia	$x = -2.969u + 18.820$	18.820	6.339	7.012
Slovakia	$x = -1.218u + 18.603$	18.603	15.273	16.915

Source: own compilation



Source: Own construction

Figure 7. Unemployment Rate - Output Gap with Linear Regression Equation in CEE Countries

We could observe that the Okun's coefficient is approximately 2% except in Poland (0.582). If the GDP decreases about 2% to the potential GDP then the unemployment rate increases 1% to the natural unemployment rate – this holds true for all CEE countries except Poland. According to my findings Okun's law is valid between 1996 and 2010 in all CEE countries except Poland.

CONCLUSIONS

We could observe that the CEE countries are differences between the major labour market indicators. It is needed deeper analysis for the further consequences. According to my second research question the Okun's law is not valid in all CEE countries (Poland is in unique situation).

One can speak of a unique transformation in the case of the Central and Eastern European countries. This was the only transformation that took place, along the main directions of the economic and political changes in the Western countries, peacefully, free of violence and, at the same time, extraordinarily fast. It is a story of success viewed from a world history perspective. The picture is different from the point of view of everyday life; the transformation caused, and, probably is causing nowadays, serious economic difficulties.

“The change of regime at the beginning of the ’90s upset the system of economic relations; Hungarian and the CEE economy are suddenly majority of its external markets. As a result of the declining living standard and the thoughtless import liberalisation the internal market for domestic manufacturers shrank extremely rapidly. This brought about the considerable decline of the agricultural and industrial production and unemployment.” (Timár 1997: 991)

Hungary, like other transition countries, had to adapt to the new social, economic and labour market conditions following the collapse of the socialist regime. The suddenly occurring

large percentage of unemployment had to be dealt with, which was partially successful since the unemployment significantly decreased between 1999 and 2001. Afterwards, before the period of accession to the European Union, it increased again and it has not yet come to a new period of decline. This was naturally coupled with a decrease in the number of the employed and the shrinking population.

Unemployment is an important and sensitive indicator of the economic growth and labour market situation in consolidated market economies. The decrease of unemployment is associated with an economic boom, growth of employment; the increase of unemployment is related to recession and the decline of employment. The change of unemployment hardly influences economic activities that are stable relative to the previous factors; these are growing according to a slowly changing trend. I intend to finish this paper on a positive tone, so I quote Kornai’s (2000:33) words: “I regard the transformation of the Middle-East European region as a success story, because it took over the capitalist economist system, putting these countries on a growth path that points towards the main sequence of history.”

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