Transition and Labour Market Policy Design
- A comparative study of the Visegrád three

Supervisor: Inga Persson
Åsa Stensson, 760119-5584
Abstract

The transition from socialistic planned economies to market economies resulted in crucial structural changes of the Visegrád (Czech republic, Hungary, and Poland) labour markets. The immediate fall in output caused unemployment rates that rose from zero to two-digit numbers within a few years. The purpose is to analyse and compare the labour market policy design of the Visegrád three starting in 1989 until recent data.

Labour market policies constitute a framework for the functioning of labour markets. A distinction is made between passive and active measures. The first years of transition were marked by an increasing rate of unemployed and a fall in the labour force participation. The willingness to register as unemployed varied along with the level and duration of social benefits. Eventually, the individual employment situations of today correspond to the success in performing the transition.

Keywords: transition, labour market policy, Czech Republic, Hungary, Poland.
Table of Contents

List of Figures and Tables .......................................................................................................... 4
1. Introduction ............................................................................................................................ 5
2. Purpose, method, and delimitation ......................................................................................... 6
   2.1 Purpose ............................................................................................................................. 6
   2.2 Method ............................................................................................................................. 6
   2.3 Delimitation ...................................................................................................................... 7
   2.4 Contents ............................................................................................................................ 7
3. Background to the transition process ..................................................................................... 8
   3.1 The historical and political background of the Visegrád three ........................................ 8
   3.2 Theoretical approaches to the transition process ............................................................ 10
   3.3 Transformation and unemployment ............................................................................... 11
4. Functioning and design of the labour market ........................................................................ 13
   4.1 How does the labour market work? ................................................................................ 13
      4.1.1 Mismatch – mobility, human capital, and relative wages ....................................... 14
      4.1.2 Labour market regulations ...................................................................................... 17
   4.2 Passive labour market policy .......................................................................................... 17
      4.2.1 Job search ................................................................................................................ 18
      4.2.2 Financing ................................................................................................................. 19
   4.3 Active labour market policy ........................................................................................... 19
      4.3.1 Job broking .............................................................................................................. 20
      4.3.2 Labour market training ............................................................................................ 21
      4.3.3 Direct job creations ................................................................................................. 21
5. Special features of the Visegrád three’s labour markets ....................................................... 22
6. Labour market policies in the Visegrád three ......................................................................... 25
   6.1 Passive labour market policies ....................................................................................... 25
   6.2 Active labour market policies ........................................................................................ 26
   6.3 Features of labour market design in individual countries ............................................... 28
      6.3.1 Czech Republic ....................................................................................................... 28
      6.3.2 Hungary ................................................................................................................... 32
      6.3.3 Poland ...................................................................................................................... 37
7. Comparative analysis of design and outcome ....................................................................... 41
   7.1 Comparative employment evolution .............................................................................. 42
   7.2 Macroeconomic factors ................................................................................................. 45
   7.3 Comparative analysis of PLMPs ..................................................................................... 46
   7.4 Comparative analysis of ALMPs ..................................................................................... 48
8. Summary ............................................................................................................................... 50
9. References ............................................................................................................................. 53
   9.1 Literature ........................................................................................................................ 53
   9.2 Websites .......................................................................................................................... 54
List of Figures and Tables

Figure 1. Unemployment rates
Figure 2. Total employment in Czech Republic
Figure 3. Total employment in Hungary
Figure 4. Total employment in Poland
Figure 5. GDP Volume Index
Table 1. Public expenditures as a percent of GDP for the Czech Republic
Table 2. Public expenditures as a percent of GDP for Hungary
Table 3. Public expenditures as a percent of GDP for Poland
Table 4. Labour force participation rate
Table 5. Long-term as share of total unemployment
Table 6. Total population
1. Introduction

The Visegrád countries, i.e. the Czech Republic, Hungary, and Poland have, in comparison to other Central and Eastern European (CEE) countries, experienced a rapid structural change, moving from socialistic planned economies to market economies. Due to their similar economic development, the countries are often grouped together and given as examples of succeeded transitional economies. Despite that, when looking closer one can observe a great heterogeneity. In this paper the similarities and differences will be made use of and put together in a comparison.

Employment policy today centres – both in the developed market economies and the post-socialist countries – on the restriction and moderation of the level of unemployment. This paper entails a comparative study of the Visegrád three, all situated in Central Europe. The governments have experienced a difficult task; to strike a balance between reducing government interventions and introducing market incentives, and further in providing an adequate social safety net that ensures popular support for the transition.

The dramatic fall in output at the beginning of transition was accompanied by sharp employment declines. Unemployment was, before that, an unknown phenomenon. The Visegrád countries were all affected by a restructuring of the labour markets, but it varied between the countries. The divergence in the rate of unemployment originates mainly from different labour demand situations of the Visegrád three. They have all, however, experienced a substantial rate of unemployment, during the time period observed.¹ A possible remedy and/or moderator for unnatural unemployment are labour market policies. The three governments selected labour market programmes, which all have resulted in varying outcomes.

The topic here is labour market policies. Passive and active labour market measures were used, to control for the new functioning of labour markets in the Visegrád three. While the former policy helps to compensate the unemployed for lost income, the latter aim at facilitating the re-entry into the labour market. “The stated objective of policies was not to prevent the rise of unemployment but to cushion its social costs and to avoid the spread of long-term unemployment.” (Boeri, 1997, p. 367)

¹ From 1989 to 2003
2. Purpose, method, and delimitation

2.1 Purpose

The purpose of this paper is to investigate the labour markets, and foremost the labour market policies of the Visegrád three. The study covers a period starting with the transition until recent data. Unemployment will be used as a measure to determine how well the labour market is working. Labour market policies are divided into passive and active policies and these are equally explored. In the comparison of the Visegrád three stress is put on differences in labour market policies.

Labour market policies constitute one kind of instruments that mainly affect the labour supply. To be able to present a broader view of the labour market situation, factors such as political background, macro economic situation, and labour demand are included. This makes it possible to analyse the development of rates of unemployment and the prevailing labour market situations in a more complex way.

During the period observed, the unemployment rates have been fluctuating, and the countries have changed their relative positions. This indicates that the employment situations have not stabilised and reached their natural rates of unemployment. Further, the enlargement of ten new countries in EU makes it even harder to predict the outcome for the Visegrád workers.

2.2 Method

This paper is based on the theory concerning labour market functioning and design, and as mentioned with focus on passive and active labour market policies. There exists an extensive Swedish literature about labour market functioning, which I have used together with the international literature on the subject. The theories are mainly descriptive, and no econometric attempts have been made on the available data. The transition specific literature on labour market policies is limited and hardly developed. Nevertheless, empirical articles emphasize certain phenomena specific for transition economies.

The empirical material has been selected by availability. The transition constitutes a popular issue to do research on, and an extensive literature can be found covering employment in CEE. Thereafter material has been gathered from statistical data, reports and information from
the Internet. Unintentionally, it implies that focus will be on the transition period. The econometric studies referred to entail data up to 1996 – 97, and thereafter it is difficult to determine effects from labour market programmes. However, a lack of comprehensive data documenting changes in employment, and labour market statistics prevails, and transition countries have been undergoing a process of revision, as to concept and methodology.

2.3 Delimitation

Some delimitation was necessary, with a subject already so extensive. First, I chose to leave out the Slovak Republic from the Visegrád countries. Their growth path diverges from the remaining Visegrád countries and they do not participate in the OECD, which has provided a considerable part of the statistics. This paper will not go into detail in what concerns wage setting. That implies that collective bargaining and trade unions are left out. The Visegrád three have varying experiences of those institutions, which normally have less influence than in the EU. Further, labour market regulations and among them employment protection legislation, is mentioned in section 4.1.2, but does not appear in the analysing chapters.

2.4 Contents

This paper consists of seven chapters, of which the first is the introduction. Thereafter I present the purpose, method, and delimitation of the paper, in the second chapter. The third chapter contains a description of the historical and political background in the Visegrád three, and further an opening to the issue of transition and unemployment. Fourthly a theoretical introduction to the unemployment literature is presented. A more detailed overview is given in the two following sub-sequences dealing with passive and active labour market policies. A presentation of labour market features in the Visegrád three starts in the fifth chapter. Labour market policies are discussed in the sixth chapter, with each country presented individually. In the seventh chapter, the analysis develops into a comparison of the Visegrád three followed by a summary.
3. Background to the transition\textsuperscript{2} process

As the Soviet bloc ranged over such a great territory and included a number of heterogeneous countries, the differences would be even more pronounced after the fall of the communist regimes. Among the most advanced countries in Central and Eastern Europe were the “Visegrád four” i.e. the former Czech and Slovak Federal Republics (CSR), Poland and Hungary. “This is a term created after their Prime ministers met on February 15, 1991 at Visegrád to pledge co-operation to speed the reintegration of their countries into Europe.” (Pollert, 1999, p. xii) Here I will include only three countries and leave out the Slovak Republic, (from here on I will refer to those three, the Czech Republic, Hungary and Poland, as the “Visegrád three”). These three countries have in common that they are recent nation states, which all obtained their present form during the 20\textsuperscript{th} century and that since the Second World War they have been ruled by socialist governments.

3.1 The historical and political background of the Visegrád three

The Visegrád three all operated a central planning system (except for Hungary, which practised market socialism, though of rather similar kind), which was the common inheritance from the communists, but to different degrees. During the communist dominance private ownership hardly existed as most productive assets were nationalised. As a consequence those economies had almost no capital market institutions. The central planning should eliminate all influences of market forces and therefore the individual initiative and effort had to be suppressed. The socialist economies were characterised by a “monetary overhang” that occurred when the amount of active money ready to be spent on goods and services was not in balance with the centrally administered supply of goods. This disequilibrium was manifested both by long queues in front of shops and by open and also hidden inflation. External trade was run between the countries within the Council for Mutual Economic Assistance, a trading bloc of the former Soviet bloc and other communist states with agreed prices and quantities.

\textsuperscript{2} Transition and transformation are two words used equivalently to describe the change of political and economic systems.
The primary instrument to obtain growth in centrally planned economies was to put investments into industrialisation. To start with this resulted in big changes for Hungary and Poland, countries that were mainly agrarian. This transformation caused losses in standards of living, among other things, and took Hungary and Poland into a path of early revolt and reform, which later gave them relaxation of central controls to prevent further revolt. Due to more autonomous state enterprises and financial institutions Hungary had an advantage when shifting to a market economy. At the same time it was however the most indebted of the three countries. Agriculture was the dominating occupation in Poland and after a failed collectivisation of the farms in the 50s this sector remained private. Poland had suffered from a recession for almost two decades before the transition began. This was caused by lack of growth and unprofitable investments and Poland experienced a troublesome economic and political period before 1989. Czechoslovakia had a much earlier industrial development and this brought growth and prosperity, which “was bargained for political conformity”. (Pollert, 1999, p. 37) Further, a high diversity in history and culture would also influence the process of transition. Although they had had a common history for almost 50 years, they all had previous institutional structures, property rights and commercial norms that they could reinstate.

“The Soviet-type centrally planned system was characterised by full employment of labour (zero open unemployment) and centrally set wages, prices and output targets for state-owned enterprises.” (Svejnar, 1999, p. 2813) Labour hoarding, i.e. the excess employment of personnel, was feasible due to the wage rates being kept low, with low differentiation across skill levels and deficient financial constraints on firms. The state dominated all economic activities, and state-owned firms were run with “soft” budgets, i.e. they had various forms of subsidies, were granted bank loans and had differentiated taxation. Eventually this system was destined to collapse owing to its inherent economic inefficiencies. When emancipating from socialism after the revolutions in 1989, the Visegrád three chose to shift to open market economies and thereby capitalism. It was soon clear that the transformation process would be more costly and difficult than expected and that removing administrative controls would also result in the emergence of unemployment.
3.2 Theoretical approaches to the transition process

Many people saw the revolutions of 1989 as an end of the socialist project and wanted the past to be buried as quickly as possible and to be replaced by market economy. This could be obtained by liberalisation, but at the expense of massive job losses. From earlier experiences of transition in Latin America, liberalisation also had to be accompanied by stabilisation programmes, which involved anticipation of recession. The Visegrád three followed the same path to quickly recover and adapt to the market economies of Western Europe and the global economy.

Hence neo-liberalism\(^3\) was dominant during the first years of transition, as this was practically the only possible strategy. There existed other theories and alternative strategies, “but they did not have the support of the powerful international financial institutions” (Adam, 1999, p. 3) and as a consequence the politicians in power came under the influence of neo-liberal ideology. This theory is in practice sometimes mentioned as “shock therapy”, meaning that all reforms are implanted at the same time during a short period.

“There is liberal strategy is based on the idea that a transformation of the planned socialist economies into market economies requires a radical economic reform which must include a radical stabilization and liberalization, carried out simultaneously, followed by privatisation. Stabilization and liberalization are closely intertwined: stabilization measures contribute to liberalization and vice versa.” (Adam, 1999, p. 6)

The laissez-faire capitalism is contrasted with the state-directed development. During this time the domestic economists and authorities were not well prepared for the transition and therefore had to rely on help from outside. The design of strategies to transform into a capitalist market economy was suggested by Western academics, financed mainly by the IMF and the World Bank, but implemented by domestic authorities.

---

\(^3\) “The neo-liberal ideology is a laissez-faire ideology, which is based on the ideas that the state’s role in the economy should be – to put it succinctly – limited to the role of a nightwatchman, that the market is almost omnipotent and social welfare should be replaced by creating conditions for the rule of equal opportunity.” (Adam, 1999, p. 182)
It all started with a price liberalisation, which threatened to result in hyperinflation. Further, the domestic currencies were excessively devalued so as to promote exports, which later carried with it extreme inflation. After that followed a stabilisation package that implied strict monetary policy with restrictions of money supply, increases in interest rates and imposition of credit ceilings. A fiscal crisis was inevitable as the tax revenue was mostly collected from the state sector, where the output fell the fastest. Losses of tax revenues were only partly offset by increased activity in the private sector. The fiscal policy also imposed constraints on subsidies at the same time as the income policy restricted wage increases to a fraction of the rising prices, which further weakened the real wages. Lower real wages and increased savings reduced the real purchasing power of the population and affected the demand negatively. The liberalisation of foreign trade made it possible for foreign products to compete in domestic markets, and hence prices would also adapt due to effective competition. Currency convertibility was also introduced to facilitate trade and to return the trust in domestic currencies instead of having the dollar as the value keeper. “Convertibility of domestic currencies and increased foreign investments have (also) improved access to Western technology and skills.” (Barr & Harbison, 1994, p. 25) The most important issue was to create a positive trade balance that would help to pay the foreign debts and hopefully enhance employment. According to the neo-liberal transition theory, stabilisation was pursued by means of privatisation where state enterprises were transferred to private ownership. It was then obvious that the deficient legislative infrastructure was also a major constraint underpinning the operation of a market economy. “Major gaps were evident in such crucial areas as the definition of property rights, the conduct of private enterprises, regulation of the banking system and other financial institutions such as insurance companies and stock exchanges, regulations of working conditions, and consumer protection.” (Barr & Harbison, 1994, p. 21)

3.3 Transformation and unemployment

The transformation would surely lead to a rise in unemployment, a fact known both by the reformers and the public, but to what extent was still uncertain. In some quarters unemployment was even claimed to be a positive sign that the transformation advanced in the right direction. Eventually though, the rate and persistence of unemployment was a determining factor for the economic development in the three countries.
“State socialism provided a regime of full employment and central planners evidently attached social value to employment, which was greater than labour’s marginal contribution to the production process.” (Boeri, Burda and Köllö, 1998, p. 2) There even existed labour shortages during socialism, especially in the CSR. In consequence of the lasting and significant labour shortage, there was also little or no structural or frictional unemployment. When moving into transition full employment was no longer sustainable; market equilibrium and the transition would involve a reallocation of labour. “The old system deployed labour inefficiently, and the introduction of hard budget constraints and competition lead to displacement of workers as firms reduced their work force or closed down.” (Barr, 1994, p. 79) Aggregate production fell and consequently there was a dramatic decline in the demand for labour. The transition was a starting shot for massive job losses through cutbacks and closures in the socialist industries.

Even though the liberalisation involved a widening of the income distribution due to market-determined wages, too high increases were not allowed so as to keep the real wages down. Further diminishing real wages were caused by the fall in output, which also increased the unemployment. “Above all, however, the labour market and specifically labour were to bear the brunt of so-called transformation costs through the reduction of real wages.” (Rainnie, Smith and Swain, 2002, p. 11) In comparison, the real wages were low even before the transition but at the same time basic commodities were subsidised. With declining wages, removed subsidies and market determined prices, poverty became an extensive problem both for those employed and unemployed.

Figure 1. Unemployment rates

![Figure 1. Unemployment rates](image)

Source: IFS MAY 2004
To begin with, the structural changes were extensive and affected all firms and institutions. Unemployment emerged due to a large-scale decline in output, which lead to mass dismissals of workers. (See Figure 1.) In this initial phase of transition, it was impossible to compensate for the rising rate of unemployment. The macro-economic policies needed to be stabilised to find out the natural rate of unemployment. Good macro-economic policies are essential for long-term economic stability, investment, and growth, including growth of employment. “The natural rate of unemployment is partly determined by transition probabilities in the labour market indicating the rate of job loss among workers, the rate of job finding among the unemployed, and the magnitude of the flows between the market and non-market sectors.” (Borjas, 1999, p. 503) But the mismatch in the labour market caused by structural economic changes could not be helped solely with macro-economic instruments. Therefore labour market policies, having a more explicit effect on labour supply, were implemented from the beginning of the transition. In this paper I will analyse how reformers and politicians have approached this problem. I will include some of the general impacts from the transformation, which have influenced the situation today. The purpose will be to analyse the design of labour market policies, and locate and observe the accompanying fluctuations in unemployment.

4. Functioning and design of the labour market

Until now I have only described the general features of the labour market and the employment situation of the Visegrád three. In this part I will first take a closer look at the functioning of the labour market. Thereafter, in the second and third subsections I will describe in particular the role of passive and active labour market policies. This will serve as the theoretical background to and point of departure for my subsequent analysis of the actual labour market policies of the Visegrád three.

4.1 How does the labour market work?

When aggregate demand fluctuates and/or structural changes take place, as seen in the Visegrád three, it is hence important that the functioning of the labour market does not
constitute an impediment. Consequently, the governments have to intervene with unemployment compensation and at the same time create incentives and possibilities for job search, to avoid excessive unemployment. In the following I will present some theories that constitute the framework for employment policies.

4.1.1 Mismatch – mobility, human capital, and relative wages

Imbalances between segmented labour markets are common phenomena, but this form of mismatch can be costly and have a restraining influence on productivity. With help of the Beveridge curve one can observe mismatch in all the forms it appears (including lack of information), through the relationship between the number of vacancies and the rate of unemployment. “Beveridge curves provide a useful perspective on potential skilled-labour shortages, as well as on structural changes in the labour market.” (OECD, 2001, p. 17) Another way to illuminate matching in the labour market is by the so-called matching function. The basic assumption here is that the outflow (number of individuals flowing) from unemployment to employment, \( O \), is a function of the number of unemployed, \( U \), and the number of posted vacancies, \( V \), that is \( O = f(U,V) \). The unemployment reflects an excess supply of labour and is related to vacancies that identify the unsatisfied demand for labour. Due to cyclical changes in demand (provided no structural changes occur) the number of vacancies will decrease as the rate of unemployment increases and vice versa. “In addition, an outward (inward) shift of the curve over time may denote a decrease (increase) in the efficiency of labour market matching.” (ibid) Depending on which kind of unemployment exists, there are several different ways in which the matching can be improved. “The process of matching is seen as a technological process of search, with both the unemployed and employers with vacant positions striving to find the best match, given exogenous factors such as skill and spatial mismatch, as well as availability of information.” (Svejnar, 1999, p. 2847)

Mobility

“Mobility of the labour force is a mechanism that counteracts structural unemployment and promotes economic growth.” (Holmlund, 1999, p. 263) Labour mobility can further be

---

4 The translation to Swedish will be “delarbetsmarknader”, an expression, which has no English equivalence.
divided into the following subgroups; line of business, occupation and geographic. The aim is that the labour should be put to use where it has the greatest productivity. Changes in supply and demand of goods and services will give rise to changes of relative wages between segmented labour markets and this in turn results in that labour tries to get away from low paid jobs to those with higher wages. In a perfect market with full information, mobility would continue until all the differences in wages (not market-related, i.e. not of a compensating kind) were eliminated.

In reality there are a number of factors, both economic and social ones, which prevent individuals from moving as soon as they are offered a better job opportunity. Depending on your age and how long you have been on the job, the turnover propensity will be smaller the older you get. Except for that, if you have a family it will be a joint decision and the gains must outweigh the losses for the whole household. There is also a correlation between mobility and educational attainment; the higher educated you are the more probable it is that you will move. Structural changes adherent to transition will give rise to a demand for labour reallocation. Labour reallocation was generally driven more by the demand side than by workers’ voluntary decisions. Many governments now emphasize the importance of mobility in order to avoid structural unemployment and promote growth. Thus they facilitate matching and mobility through employment services and “moving” subsidies. The policies concerning this will be dealt with in section 4.3 below.

Relative wages

In the neoclassical model, as mentioned above, firms pay workers a wage, which clears the market for labour. Still, the government or unions can intervene to protect workers. Some countries choose to have a minimum wage that is a nominal wage that is set above the equilibrium level of a competitive market. At this level the labour demand is lower than initially and some workers will be better off while others will be displaced from their jobs. Those that are displaced can have a crowding effect on other “uncovered” markets where they will increase the labour supply and at the same time lower the wages. One can expect minimum wages in transition to generate more unemployment, ceteris paribus, both because they will act as constraints to wage adjustment and because wage floors will hinder the creation of low productivity jobs in the new sectors. The group that was able to stay with raised wages could be regarded as “insiders” and those displaced as “outsiders”. The insider-
outsider problems work as a security for insiders and as a threshold for outsiders to enter the labour market. A well-known fact is that unions look after their members’ (the insiders) interests. The solidarity includes only the members and when the overall wage level is negotiated centrally the unemployed (the outsiders) are not taken into consideration. Even though the unemployed are willing to work at the existing or even a lower wage, this will not be realised due to the power of the unions and implicitly the insiders.

**Human capital**

Human capital is often thought of as a process of learning and a personal investment. People learn to be of use for firms, so that their marginal productivity is increased. There is both a private and a social rate of return on education, and this is one of the means through which growth can be sustained in the long run. In this case the main focus will be on human capital as a form of reallocating workers.

When reforming a society, one must also follow up with a renewal of the human capital possessed by the population. Traditional sectors such as agriculture and industry together with public administration will change and take new forms. In the Beveridge curve one could observe shifts due to skilled-labour shortages. “Structural unemployment thus arises because of a mismatch between the skills that workers are supplying and the skills that firms are demanding.” (Borjas, 1999, p. 473) The progress of technology has reallocated the importance of labour to capital in the production function. The shortages of labour supply appear nowadays in sectors with a quick pace of development such as high technology.

The government has therefore an important role to update the schooling system and offer retraining programmes for the unemployed. The “new” generation has the possibility to attain the skills demanded. Those workers educated in the old system are hence forced to start retraining. One can also grant an early retirement pension for the workers who are not cost-efficient to retrain. Not only education, but even work experience (on-the-job training) has partly lost its value. In general there has always been a higher rate of unemployed among low-skilled workers. Even though retraining programmes can be offered those exposed will experience a greater risk of remaining in long-term unemployment. This will be further discussed in section 4.3 below.

---

5 Includes agriculture, hunting, forestry and fishing
6 Includes manufacturing, mining and quarrying, electricity, gas and water, and construction
4.1.2 Labour market regulations

The pre-transitional labour market regulations were of less importance for the Visegrád three due to job guarantees and a wage policy, which showed solidarity. When adopting new employment protection legislations, the question was where to be on the “labour market flexibility” scale. The influences could either come from the U.S.A., with a liberal employment legislation, or Europe with a tradition of extensive legislation of job security emerging from strong trade unions. In Europe one has experienced “stickiness” in the hiring and firing of labour. Due to different kinds of fixed labour costs the firms must regard hiring as a form of investment and the aggregate labour demand will include fewer workers. In a simplified way one could say that there is a trade-off between security and chances of getting a job. Even here the cost-benefit analysis may be used to estimate whether the gains from hiring a worker will exceed the costs that are sunk once someone has been employed.

The lack of labour market flexibility in Europe has been named by scientists as “eurosclerosis” and is an explanation to the long period of high unemployment during the two last decades. This problem has been emphasized in the research on design of labour market policies. With this “new” awareness, the Visegrád three have chosen legislation under the influence of both OECD and EU. Yet each country has to reach its viable compromise between labour market flexibility and employment security. Even the strong growth of the informal sector can be regarded as part of the process of labour market flexibilisation.

4.2 Passive labour market policy

The most explicit effect of being unemployed is certainly the reduction in income. “Unemployment compensation can be perceived as a subsidy of labour market work, and this brings up a possible link between unemployment insurance and labour supply.” (Björklund & Holmlund, 1991, p. 141) Due to imperfect information the workers cannot be fully compensated as the risk of moral hazard exists and could result in diminishing incentives for job search. Hence an important question for social policy is the nature of the trade-off between equity and efficiency effects of the unemployment benefit system. In this section I will discuss the microeconomic search model and how the level of unemployment insurance,

---

7 Composed of information, hiring, training and firing costs.
8 The Visegrad three are all members of OECD since 1993 and coming EU members in 2004
set out from prevailing passive labour market policy (PLMP), affects job search. Another
discussion is that of how the insurance system should be financed to be efficient.

In most countries the unemployment insurance is financed publicly (or at least partly) as
no private insurance company would take this role due to asymmetric information. One can
only assume that the state of unemployment is involuntary. It is therefore important to observe
how the workers allocate their time and their labour supply. Every individual has different
preferences for consumption and given a wage this will affect the hours-of-work decision.
The combination of goods and leisure will give the total consumption. Hence there are
individuals that value leisure more than goods. “The unemployment compensation that would
make the average worker indifferent between working and being unemployed could be
extremely attractive to those who value leisure highly.” (Bosworth, 1996, p. 285) To
understand the level of compensation from an efficiency point of view I will describe the job
search theory.

4.2.1 Job search

“Because different firms offer different job opportunities and because workers are unaware of
where the “best” jobs are located, it takes time to locate the available opportunities.” (Borjas,
1999, p. 477) There is a benefit from continuing the search of job offers as the possibility of
finding a higher-paying job always exists. This is compared to the cost of search; direct costs
e.g. phone calls, tickets and an indirect cost –the opportunity cost of not working. The
marginal benefit of search decreases and the marginal cost increases with the duration of
search, i.e. there is less gain from additional search and it is more costly even though the
offers get better. At one point the marginal benefit and marginal cost curves intersect and this
will determine the expected duration until search ceases and an employment offer is
accepted.⁹ Here the intersection tells us the optimal number of weeks to search for a job given
the current level of unemployment insurance. The opportunity cost that inter alia determines
the marginal cost is affected by the access to insurance. Therefore the marginal cost curve will
shift according to the replacement ratio (percentage of income replaced by insurance) and the
maximum length of benefits. If e.g. the replacement rate is increased by ten percent there will
be a “southeast” shift in the MC-curve and the expected duration will increase.

“Unemployment insurance systems with a fixed maximum duration period may also produce

⁹ The job-search model does not take into count changes in labour demand.
falling reservation wages over the spell of unemployment, and therefore lead to “positive duration dependence”; the probability of leaving unemployment would then increase as the duration of the spell increases.” (Björklund & Holmlund, 1991, p. 140) In the same way there is a positive correlation between the replacement ratio and duration.

The results from empirical research diverge on this matter and even though some studies show that a generous benefit system could extend the unemployment duration, it is not overall significant. Sometimes the opposite is claimed, that a high replacement ratio would entail a shorter duration. Generally the duration for high-wage workers is shorter as they have low replacement ratios and thus a higher opportunity cost from not working. A maximum unemployment benefit duration of about 50 weeks, i.e. one year, is an average for many countries with extensive social security. Depending on how the active labour market programmes are designed, the reservation wage may differ the closer the date of expiration one comes. Actually it is hard to determine what design is most efficient in a cost-benefit analysis. “It is important to note that the optimal system would probably not be identical to the system that gives maximal employment.” (Holmlund, 1999, p.13)

### 4.2.2 Financing

The aggregate spending on unemployment insurance is partly a function of the number of unemployed. “Differences in benefit quantity and duration, and in coverage rates, translate into differences in unemployment insurance spending.” (Funck & Pizzati, 2002, p. 251) If a government’s expenditures for unemployment insurances are financed primarily by payroll taxes, this will cause a fiscal pressure when unemployment is on the rise. In the long run all workers implicitly “pay” these contributions in the form of lower net wages. The taxes will almost work as a personal insurance fee and this leads further to an incentive for restraint in wage bargaining. Alternatively, the unemployment insurance system could be partly self-financed. Due to adverse selection the workers with an increased risk of becoming unemployed would utilize the insurance system to a greater extent than low-risk workers. Eventually it would result in diversified private insurances, with the high-risk group paying a higher premium.

### 4.3 Active labour market policy
“Most countries in the EU and the OECD devote more resources to their passive labour market policies than to their active ones.” (Funck & Pizzati, 2001, p.255) This does not imply that the latter is subordinated and less important. Countries\textsuperscript{10} with a higher rate of active labour market policy (ALMP) often also have relatively generous programmes of unemployment benefits. The two policies are thus complementary and eventually the final impact on unemployment is always the main task. Due to active policy programmes it is possible to strengthen and speed up systemic and structural adjustment at the micro-level. They are further continually adjusted to respond to labour market developments and differ according to employment goals. The direct effects of ALMPs are questioned but an adequate evaluation should be carried out in the medium and long run.

Active policies aim at facilitating the re-entry into the labour market once being unemployed. My point of departure for categorising the different ALMPs is drawn from a paper written by Lars Calmfors “Active Labour Market Policy and Unemployment – a Framework for the Analysis of Crucial Design Features” in 1994. His subcategories are; (i) \textit{job broking} with the purpose of making the matching process between vacancies and job seekers more efficient; (ii) \textit{labour market training} in order to upgrade and adapt the skills of job applicants; (iii) \textit{direct job creation}, that may take the form of either public-sector employment or subsidisation of private-sector work.

4.3.1 Job broking

By means of the Beveridge curve one could measure the effectiveness of the matching process between vacancies and unemployed. The purpose is to obtain a shift in the curve to the left so that vacancies become filled more quickly and become less costly. The mobility between sub-markets e.g. both geographically and between different businesses must work smoothly and not be an obstacle causing unnecessary unemployment. Some examples of how the employment services ameliorate the matching; counselling and vocational guidance, job search courses, assistance with geographic mobility, and intensive counselling for disadvantaged with a plan for their special requirements. Labour offices also have the purpose of organizing social and occupational rehabilitation services for disabled workers. This is the first step to help the unemployed, and active job search is often a compulsory requirement for eligibility to unemployment benefits.

\textsuperscript{10} Among others Sweden
4.3.2 Labour market training

“The idea is that people on job search should be offered training in professions where it prevails shortage of labour.” (Ackum, Agell et al., 2001, p. 6) The labour supply must be maintained and to avoid that workers become long-term unemployed or leave the labour force, skill-enhancing programmes are set in. It is often a matter of retraining unemployed who come from sectors stricken with structural unemployment. As the human capital of such unemployed has become “unproductive” they will be encouraged to invest in skills in a more profitable area. Further, this is an instrument for the government to control and speed up the economic development in certain areas. For example it could entail investments in training for growth enhancing sectors. Labour market training has been crucial in particular for countries in transformation. The skills connected to the previous form of government become obsolete and a period of retraining starts.

4.3.3 Direct job creations

Subsidized work can contain many different programmes and involve both the private and the public sector. Not only is the purpose to decrease unemployment but also to some extent to create new jobs. The aggregated benefit of subsidizing work has been questioned as one interferes with the regular market, which might involve undesirable side effects. Despite this it may help discouraged workers and enhance the chances of future employability. A first type of programme is subsidies for regular employment i.e. wage subsidies for recruiting or retraining particular workers (such as long-term unemployed). A second type is temporary work in the public sector. And third, there are start-up allowances in the form of grants or prepayment of benefits to allow the unemployed a capital sum to start up their own business.

To sum up, in order to succeed “one must try to strike a balance between providing the unemployed with better opportunities and at the same time maintaining sufficient incentives for individual job search as well as for collective wage-setting behaviour.” (Calmfors, 1994, p. 30) The programmes should be targeted so as to provide insiders with more competition but at the same time not to crowd them out. It involves a risk of crowding-out when one offers wage subsidies or creates public work that compete with a private counterpart. The duration
of the programmes should not be too long to avoid locking-in effects. “It may also be wise in many countries to combine an increased emphasis on active labour market programmes with a reduction of the maximum duration of unemployment benefits in order to avoid undesired incentive effects.” (ibid) Provided that the co-ordination between passive and active labour market policies functions, those could have a considerable effect on unemployment.

5. Special features of the Visegrád three’s labour markets

Policy interventions in labour markets are normally justified by failures or distortions, either caused by the market itself or by governments. “In the context of systemic transformation, additional distortions arise from asymmetric information, absence of well-understood or well-defined property rights, incomplete information about the workers’ qualifications and skills, lack of coordination in decision-making, poorly organized labour markets with potential for search externalities, and high mobility costs arising from malfunctioning housing and property markets.” (Boeri, Burda and Köllö, 1998, p. 69) Within this broad context of transitional effects on labour, I mainly undertake an analysis of labour market policies with respect to unemployment.

“The transition process from planned economies to market-oriented economies involves substantial reallocation of labour. ... In the process of transition, employment had to flow out of sectors like state-owned heavy industry into the new, private, mostly small-scale business sector. The success of transition in a given country can be assessed by how well the problem of reallocating labour has been addressed.” (Boeri & Terrell, 2002, p. 51)

An emerging economic structure was moving towards that of other market economies, away from over-sized industrial and agricultural sectors, and towards the service sector that was underdeveloped before the transition. The beginning of the transition process in 1990 coincided with a negative aggregate demand shock through the collapse of CMEA trade and stringent budgetary policies to stabilise the macro economy. The labour force composition changed in several ways and employment losses went along with falling activity. Due to this
complex situation, new systems of social insurance were developed, firstly to cushion the blow of transition and thereafter to support the recovery of growth. Depending on how the unemployment system covered the losses from being laid off, workers were left with two alternatives. Either people chose to register as unemployed or they followed the great outflow from the labour force. Soon it became clear that the decline in employment would be much greater than the growth in unemployment. "The reasons for the decrease in activity rates (were) manifold; the increase in early retirements and disability pensions, the reduction of working pensioners, the “discouraged worker” effect (jobless persons no longer actively seeking new employment opportunities), the return of unemployed people to education, and employment in the informal sector.” (Funck & Pizzati, 2002, p.28) Despite a macroeconomic recovery starting in 1993 – 94, this has only enhanced the employment rate temporarily. Economic recovery in the transition economies has often proved elusive or unsustainable once achieved, with further negative consequences for employment. Labour turnover tends to follow a counter-cyclical pattern in the transition countries, which indeed contrasts with the situation in the advanced industrialized countries. The explanation lies in the structural imbalances accumulated under the system of central planning because of the distortion of relative prices and poor economic performance of any investment projects. A strong recovery will, however, never bring a return to zero unemployment and the activity rates have reached the average employment rate in the EU about 70 percent. Given the macroeconomic situation in the CEE countries, labour markets probably perform less effectively than they do in OECD countries. Depending on the institutional setting in the given countries, the sharp decline in output at the start of the transition was hence absorbed either by employment or wage decreases. Priority was typically given to combating unemployment, notably by preserving existing jobs (often labour hoarding), while the issue of employment quality, flexibility and the effects of labour market regulations were considered less important.

Section 6 below will concentrate on each individual country, but before that I will present an overview of labour market functioning special to all the Visegrád three. The focus will be on structural change and adjustment.

The Visegrád three all show regional asymmetries with leading and lagging regions. (The unemployment) “has been more concentrated in rural areas while country capitals display very dynamic labour markets.” (Boeri & Terrell, 2002, p. 63) The reservation wage function suggests that the opportunity cost of working is higher in rural areas than in urban areas. The value of the gap between cash transfers and wages has become larger in urban areas. Due to no adjustment of the cost of living for workers in urban areas this creates an
incentive to job search. Nevertheless, the probability of longer-term unemployment in rural areas increases. In spite of wage differentials and widening unemployment, the interregional mobility is likely to remain low. The international migration has changed drastically though. “Until recently there was no entering or leaving from the CEE, but in recent years\textsuperscript{11} the frontiers have opened and some of the countries have become target countries, as well as transit countries for migration to the West, and/or have also become labour exporting countries.” (Timar, 1995, p. 640) If the earning differentials with the market economies persist, there will probably occur a flow of highly skilled workers moving from east to west. In the short run international migration improves the labour market situation by mitigating the unemployment.

However an article by Dövenyi & Ingham suggests that some economic activities might be subject to labour shortage constraints. Certain urban agglomerations still have a low rate of unemployment. Supply deficiencies have effect on the demand side of the market, which imply a shortage of certain categories of manpower coexisting with growing unemployment. Shortage remains a feature at least of labour markets in the major urban areas in the CEE\textsuperscript{12}. “With fiscal and monetary prudence high on the list of policy priorities, and with labour market mismatch a crucial determinant of the natural rate of unemployment the dangers are evident.” (Dövenyi & Ingham, 1999, p. 31) The enterprises in competitive situations have confronted the problem of shortages with higher wages and hour adjustments. Labour shortage could still be an ongoing issue for the transition economies for some time to come.

As the communist regimes stressed equality and strove to privilege workers over the “intellectuals”, the rate of return on education was low under central planning. At the same time the human capital and experience gained under communism may not be very useful in a market economy. Therefore the rate of return from this former education and experience has fallen from the transition and onwards. Turning into market economies has been a disadvantage for low-educated workers as the rate of return on schooling has increased. There has been an overinvestment made by previous regimes in vocational schools. The workers who received this form of training are now overrepresented among the unemployed. The overall enrolment in schools increases, with exception for the vocational schools.

Rewarding heterogeneous skills with differentiated wages was a new phenomenon that arose with the market-oriented economy. The revolutionary expected effects were however mitigated due to tax-based penalties and penalties on firms granting wage increases above a

\textsuperscript{11} The article was written in 1995, and is referring to the first years of transition
\textsuperscript{12} Especially concentrated to the capitals: Warsaw, Prague, and Budapest
given norm. But those reforms had less impact because of design problems. At the same time minimum wages were legislated but were never de facto used as a policy tool, due to weakness of bargaining institutions and a lack of efficient networks of labour inspectors. The minimum wages have however played an indirect role as they have served as the basis for calculating most social benefits such as, welfare, unemployment, and health benefits. With no tradition of strong unions, the workers were represented by workers’ councils, that is one of the institutions that helped maintain the real value of the workers’ earnings. In countries with high nonemployment benefits, which constitute a wage floor, the aggregate wage declines were much less pronounced. A comparison of the Gini-coefficients, measuring inequality in pre- and post-transitional earnings, shows a modest increase in inequality in the Visegrád three.

6. Labour market policies in the Visegrád three

The Visegrád three have a short story of income support systems for the unemployed and this has forced the public authorities to transform unemployment benefit systems and to alter significantly the composition of their active labour market policy budgets over the years. Normally unions, minimum wages and employment protection legislation are considered important in determining the rate of unemployment and the wage setting. In this case, programmes for the unemployed have been the most influential institution, by affecting search behaviour and the reservation wage of workers flowing from one sector to another. In addition, other types of benefits and programmes have played a role. “In countries with weak unions, low and unenforced minimum wages, and low and falling unemployment benefits, the whole battery of subsidies available to nonemployed individuals of working age acts as a floor for wage levels.” (Boeri & Terrell, 2002, p. 68)

6.1 Passive labour market policies

At the first stage of transition, priority was given to passive labour market programmes that needed to function, and were adjusted so they would not cause unnecessary expenses for the

---

5 Table 6.1 – 6.3 show expenditures on LMPs and are presented in each country-specific sector
governments. The people cut off from work needed first of all a social protection and finding a new job became secondary. The unemployment benefits were generous to start with, but budgetary restraints quickly forced the public authorities to tighten the eligibility constraints for benefits and reduce their maximum duration. Trends in spending on unemployment compensation also reflect changes in the number of the unemployed. The policy changes resulted in a dramatic decline in the proportion of jobseekers and immediately affected the level of labour force participation. The limitation of the benefit entitlement period reduced the support for the long-term unemployed. As the Visegrád three experienced different outcomes, I refer the reader to the individual analysis of each country below (Section 6.3). Many workers left the labour force and moved into the category of means-tested social assistance. Unlike the unemployment benefit, the social assistance is open-ended and with no requirements of job search. Another nonemployment benefit that became rather common was the liberal access to early retirement and disability pensions.

For the unemployed remaining in the labour force there are ambiguous results as to whether the rate and duration of unemployment benefits affects the outflow. Many studies used the opportunity from the transition to study the correlation between declining unemployment benefits and work incentives. None of these studies point to a significantly increased outflow after the tightening of the unemployment insurance systems. “Firm evidence on disincentive effects of benefits in Eastern Europe is thin on the ground.” (Micklewright & Nagy, 1996, p. 823) The elasticities of unemployment duration with respect to changes in benefits turned out to be low (0.1 – 0.7) in comparison to other OECD countries. Various results suggest that policymakers in both the low and high unemployment transition economies have considerable latitude in providing an adequate social safety net without jeopardising efficiency.

6.2 Active labour market policies

After the first phase of transition, ALMPs have now come to play a more important role in the Visegrád threes’ economies. The PLMPs have stabilized and active programmes are considered to be a complex attempt to combat unemployment. The expenditures on those policies are relatively low compared to Western economies. Almost all the types of ALMPs
mounted in the OECD countries can be found in the Visegrád three.\textsuperscript{14} Common ALMPs for the three countries are: subsidised employment e.g. public works, training & retraining and youth measures. Expenditures on different measures mostly follow the order above. The foremost objective of the programmes is to bring disadvantaged people into contact with work. Disadvantaged groups often include: long-term unemployed, minority groups, and disabled individuals. Despite the criticism that sometimes is presented, active programmes also entail positive externalities. For example, participants might see a new perspective for their lives through an ALMP programme. In a longer perspective even crime rates may be lowered.

“In the empirical programme evaluation literature, the main microeconomic questions are, first, whether it is possible to target problem groups effectively, second, whether participation in ALMPs increases an individual’s employment probability in the short as well as the long run, and third, whether there are any income effects.” (Puhani & Steiner, 1997, p. 210) There are several doubts concerning ALMPs that are often emphasized, e.g. their cost effectiveness and whether they cause deadweight losses. Evaluations show different results on the effect on outflows to jobs; in favour of ALMPs but also insignificant results. Several studies, performed on post-socialist countries, found that expenditures on ALMPs have significant positive effect on outflows to jobs. Training is found to improve labour market opportunities only a little, whereas it could provide a long-term investment into the human capital. Further, public works have a negative effect on employability, probably due to a negative signalling effect. Concerning job subsidies, there may be an implicit effect from contacts with employers that brings multiplier effects. “Nonemployment subsidies also operated as a subsidy to job-creation in the new sector, as the self-employed and the new small business sector were allowed to combine benefits and earnings from work obtaining explicit or hidden seed capital for the start-up of new entrepreneurial activities.” (Boeri & Terrell, 2002, p. 72)

However the effect of the programmes is weakened through a deficiency of labour demand common to all CEE countries. There is little hope that big firms established before 1990 will be able to increase their product demand, but faith is put in new establishments. The newly established firms often require a high level of skills and therefore training and retraining become the most promising labour market policies.

\textsuperscript{14} Some country specific features are described in the section 6.3 below.
6.3 Features of labour market design in individual countries

6.3.1 Czech Republic

The Czech Republic (CR) seemed for a long time to be an exception among the CEE countries, with a very low rate of unemployment. (See Figure 1.) In the transition literature one often refers to the “Czech miracle”, and it was among the countries, which made the fastest progress in economic reform. The impact of economic transformation was more severe in Slovakia than in CR and became one reason for the split up of former Czechoslovakia on January 1, 1993. CR had rather favourable initial conditions, such as very low inflation and low foreign indebtedness. The explanations for the “Czech miracle” are mostly related to economic conditions at the outset of the transformation: specialisation of production; a well-educated labour force; employment in services, and a relatively small agricultural sector. Together with the reform a so-called “small” privatisation – essentially, the restitution of formerly nationalised property to the owners or their heirs – began. “The “big” privatisation started in 1992: vouchers were distributed among the population to be exchanged either directly for shares in enterprises to be privatised or for the shares in investment funds that would manage the vouchers on behalf of their shareholders.” (Nesporová & Uldrichhova, 1997, p. 49) The post-privatisation period has been characterised by a large restructuring of share ownership and new owners have started to emerge. Dispersed ownership turned out to be less efficient than expected, and as a consequence the new owners have had to reduce employment levels. The postponed process of restructuring of certain sectors together with a slowdown of the economy caused a substantial rise in the unemployment rate in the second part of the 1990s.
Labour market situation

The Czech labour market was almost an ideal model of a transition labour market, characterised by high outflows as well as inflows, with unemployment representing a transitory state between old and new jobs. The highest level of job losses occurred in 1991 with a total of 1.035,000 of which a majority was in agriculture, industry and construction. In the same year about 750,000 new vacancies were created, mainly by private entrepreneurs. The Czech labour force has shown signs of high flexibility and labour mobility during the transition. Nevertheless, labour productivity was still lagging behind and partly due to an increase/stagnation in labour hoarding. Average real wages much below the pre-reform level had made it possible to postpone extensive unemployment. This in turn prevented sound structural changes. At first unemployment spells tended to be rather short. Redundant labour was mostly absorbed by new segments of the economy, and the size of the labour force decreased through a reduction in the number of working pensioners and early retirements.

In return, CR has been the only Central European country to face recession in the second half of the 1990s. (See Figure 2.) The current labour market situation conceals many problems, and the most outstanding is that of long-term unemployment, concerning redundant workers who cannot be transferred to the upcoming sectors. The retiring generation of workers is relatively small. Together with new labour market entrants, the older workers constitute an increasing working-age population. Further, CR experiences a steady and sharp increase of differences in unemployment among regions.
Institutional framework

The Employment Act, and the Act of Czech National Council date back to 1991 and set out the basic legislative framework of the employment policy. “The employment act specifies the “right to employment”, which every citizen is granted by the constitution.” (“Joint assessment of the employment policy priorities of the Czech Republic”) In turn, the Czech Public Employment Service (PES) has the task to provide income support and “active” assistance in finding suitable employment. The PES operates a national administration and a network of district labour offices with local subsidiaries. Czech labour offices register jobseekers and collect information about available vacancies from enterprises. “Employment services provided to jobseekers include information about existing vacancies, job counselling, vocational guidance and assistance, information about available employment programmes and the payment of unemployment benefits.” (Nesporová & Uldrichhova, 1997, p. 63) Changes in the legal and institutional framework are discussed and agreed in tripartite negotiations.

PLMPs

Over the years the aggregate labour market policy expenditures have been relatively stable, but with more emphasis being placed on passive measures. (See Table 1.) As in most transition economies changes were introduced in the early labour market policy. Thus, in 1992 the maximum duration of the unemployment benefits was halved from 12 to 6 months. Under the Employment Act, an unemployed person is guaranteed unemployment benefits within seven days of registration, if not offered a suitable job. Benefits will then last for up to six months, and are based on previous average net earnings. In the first three months, the benefit amounts to 60 per cent of the prior wage and thereafter it equals 50 per cent. An upper limit on unemployment benefits exists, but no lower limit. An early retirement scheme was introduced in 1991 and was granted to people who had been employed for at least 25 years, and two years prior to the statutory retirement age. Social insurance funds cover early retirement pensions, that is, no resources earmarked for employment policy are used.

In CR the unemployment compensation system has only had a moderate negative effect on economic efficiency in terms of lengthening unemployment spells, and the elasticity of
duration with respect to the level of benefits is found to be 0.6. However, during the last weeks of entitlement one can observe a higher exit rate, which might indicate that a perverse incentive effect prevails. A similar probability of finding a job prevails for the least and most educated among the unemployed, except for individuals with vocational high school education.

Table 1. Public expenditures as a percent of GDP for the Czech Republic

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public employment services</td>
<td>0.10</td>
<td>0.11</td>
<td>0.11</td>
<td>0.10</td>
<td>0.08</td>
<td>0.08</td>
<td>0.09</td>
<td>0.08</td>
<td>0.07</td>
</tr>
<tr>
<td>2. Labour market training</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>3. Youth measures</td>
<td>0.03</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>4. Subsidised employment</td>
<td>0.04</td>
<td>0.04</td>
<td>0.03</td>
<td>0.01</td>
<td>0.02</td>
<td>0.03</td>
<td>0.05</td>
<td>0.09</td>
<td>0.09</td>
</tr>
<tr>
<td>5. Unemployment compensation</td>
<td>0.16</td>
<td>0.18</td>
<td>0.15</td>
<td>0.15</td>
<td>0.20</td>
<td>0.23</td>
<td>0.31</td>
<td>0.30</td>
<td>0.24</td>
</tr>
<tr>
<td>6. Early retirement</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>TOTAL</td>
<td>0.34</td>
<td>0.35</td>
<td>0.31</td>
<td>0.29</td>
<td>0.32</td>
<td>0.36</td>
<td>0.50</td>
<td>0.52</td>
<td>0.45</td>
</tr>
</tbody>
</table>

Active measures (1 – 5) | 0.18 | 0.18 | 0.16 | 0.14 | 0.11 | 0.13 | 0.19 | 0.22 | 0.21 |
Passive measures (6 and 7) | 0.16 | 0.18 | 0.15 | 0.15 | 0.20 | 0.23 | 0.31 | 0.30 | 0.24 |


**ALMPs**

In contrast with the other Visegrád countries, more personnel was used for job broking functions than for unemployment benefit administration in CR. With a low initial unemployment rate, high priority was given to ALMPs and they were integrated with the labour market to a higher degree. “The careful design of training courses according to the actual needs of the labour market, the selection of trainees and the still relatively modest scale of training (...) are the main reasons for the high proportion (over 70 per cent) of those who find a new job after retraining.” (Nesporová & Uldrichhova, 1997, p. 65) Nevertheless, in the mid 90s the number of persons supported by ALMPs sank drastically, and unemployment benefits became the dominant policy.

Job creation programmes, known as “socially purposeful jobs”, are allocated most expenditures of all ALMPs, and constitute the most widespread form. These forms of subsidised employment are mainly aimed at selected groups of jobseekers, such as people
with disabilities, school leavers or persons interested in starting their own business. The state provides a financial contribution to compensate for the cost of creating a new job, and the funding can be provided in the form of a subsidy, as soft credit or to cover the interest on a commercial loan. After the transition these programmes have been used for hard-to-place workers such as Romas or in regions with higher unemployment. To promote the employment of young people, employers may receive a subsidy from the labour office towards the wage. Labour offices also provide traditional public work programmes, mostly organized by municipalities and offering seasonal work that does not require any special skills. In addition, labour offices organize retraining for the registered unemployed. Even employed persons who desire to improve their capacity or are interested in changing their occupation, have the opportunity of retraining through programmes partially financed by the labour office. Training and retraining have, however, been given low priority in CR.

There was a policy of general support to the development of small and medium-sized enterprises (SMEs) formulated in 1992. This policy covered the employed as well as the unemployed and its purpose was to facilitate access to capital and to provide supporting services. By providing seed capital to new businesses, which otherwise rarely had access to bank credits, one speeded up employment restructuring and the development of the private sector. A network of regional information and consulting centres was set up, including centres formerly used for ALMPs. The creation of new jobs has been one of the basic criteria used in the selection of programmes.

6.3.2 Hungary

Compared to other post-socialist countries, Hungary was rather well prepared for a market economy. For example state enterprises were more autonomous and the price system was more liberal and rational. Nevertheless, Hungary experienced the same fall in labour demand, which led to an unemployment rate that peaked at a level of 12% in 1993. (See Figure 1.) “The most dramatic development was the increase in unemployment from 20,000 to more than 700,000 between 1990 and the beginning of 1993.” (Frey, 1997, p. 111) In the initial phase of the transition the government gave priority to anti-inflation measures over the prevention and mitigation of the increase of unemployment. Employment policy consisted mostly of tasks related to the management of unemployment and without a future prospect.
However, a gradual economic reform has resulted in rapid economic growth, and Hungary experiences today the lowest rate of unemployment among the Visegrád three.

*Figure 3. Total employment in Hungary (thousands)*

![Graph showing total employment in Hungary from 1992 to 2002.](image)

Source: IFS MAY 2004

**Labour market situation**

Hungary has a strikingly low labour force participation (around 60%, see *Table 2*.), which has continued to decline throughout the transition. “The authorities responded to rising unemployment associated with market-based restructuring by creating a comprehensive system of early retirement, light-disability and welfare benefits that reduced the labour force participation rate to well below the OECD average by the mid-1990s.” (“Joint assessment of the employment policy priorities of Hungary”) The transition involved a widespread withdrawal of unqualified displaced workers (especially those aged 35 – 49 years) and thus a drop in the employment. (See *Figure 3.*) The rise in unemployment has, however, never been as dramatic as the job losses. Consequently, increasing the labour force participation is a main task for further labour market reforms. The first adjustments in the Hungarian labour market implied a reallocation of labour between sectors. It had an explicit negative effect on employment and labour force participation during the first years of transition. Pay-off was not slow to follow, with a strong increase in labour productivity.

Significant regional differences remain for the labour market, and have no remedy due to low internal mobility. The Roma are much higher represented among the unemployed than among the total population. Young people are also disproportionately hit by unemployment. In contrast, women have a lower unemployment rate than men, which is rather unusual in European countries. It can though be explained by a significant percentage of working-age
women having been added to the number of inactive, which is not reflected in the unemployment rate. Eventually, Hungary may be experiencing a long-term labour supply shortage if the population continues to decline, which is the case at the moment.

_Institutional framework_

“Hungary started to build up an organization and programmes for preventing unemployment and for providing services to the unemployed in the 1980s.” (Frey, 1997, p. 89) This has served as the basis for the present organization – the Employment Act - and came into force in 1991. The Employment Act sets the conditions for unemployment compensation. Labour market policies are implemented by the Public Employment Service. The institutional structure of labour market policies in Hungary reflects a great influence of the German model. This implies that the central organ is the national labour centre, which exercises control over the county labour centres.

_PLMPs_

Three forms of compensation exist in Hungary: unemployment benefit (which is a contributory insurance), school-leaver’s unemployment assistance, and early pension. At first the entitlement period for unemployment benefit was two years. Due to a cut in public expenditure, the entitlement was reduced to one year in 1993 (with shorter periods for those without good contribution records). Despite that, the duration of unemployment increased rapidly during this period and long-term unemployment became a serious problem in Hungary. Hence, the most common way for an unemployment insurance spell to end was with exhaustion of entitlement. Those who ended their benefit period were in addition covered by means-tested unemployment assistance (UA), which was introduced in 1992 as a response to the problem of unemployment insurance exhaustion. From mid-1994 the most common benefit received by the registered unemployed stock was means-tested UA. The unemployment assistance now constitutes the most important single local social assistance scheme. However, a lower propensity to search has been observed among those receiving UA. In a study that examined the effect of a major reduction in entitlement in the Hungarian compensation scheme in 1992, no or little evidence was found that a more austere scheme would raise the job exit hazard near the date of expiration.
A low average wage level is reflected in the benefits received by the unemployed. To begin with the benefit level was linked to the minimum wages, but later it was replaced by a fixed minimum benefit. In fact, a majority of the beneficiaries receive less than the minimum and very few obtain the maximum limit. In addition, the Employment Act allows benefit recipients to work and earn up to the amount of the current monthly minimum wage.\textsuperscript{15} With low unemployment benefit levels and shorter periods of entitlement, the government has succeeded in restraining the public expenditures on passive measures significantly. (See Table 2.) Through school-leaver’s unemployment assistance, young people without work and who have graduated recently can obtain assistance similar to the unemployment benefit. The extension of assistance has clearly encouraged youth unemployment, and at the same time the proportion of school-leavers has risen among the registered unemployed. The early retirement pension has been easy to access. Under the conditions that the unemployed worker has at most three years to retirement age (age 57 for men and age 52 for women), a period of service of 20 years, and sees no chance of being offered a suitable job in the long run, he/she can instead obtain pension insurance. Thanks to fewer demissions caused by structural changes, this form of benefit is about to disappear.

\textit{Table 2. Public expenditures as a percent of GDP for Hungary}

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public employment services</td>
<td>0.15</td>
<td>0.15</td>
<td>0.13</td>
<td>0.11</td>
<td>0.13</td>
<td>0.12</td>
<td>0.11</td>
<td>0.11</td>
<td>0.11</td>
</tr>
<tr>
<td>2. Labour market training</td>
<td>0.23</td>
<td>0.19</td>
<td>0.13</td>
<td>0.08</td>
<td>0.08</td>
<td>0.07</td>
<td>0.07</td>
<td>0.07</td>
<td>0.07</td>
</tr>
<tr>
<td>3. Youth measures</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>4. Subsidised employment</td>
<td>0.28</td>
<td>0.27</td>
<td>0.17</td>
<td>0.18</td>
<td>0.23</td>
<td>0.20</td>
<td>0.22</td>
<td>0.22</td>
<td>0.29</td>
</tr>
<tr>
<td>5. Unemployment compensation</td>
<td>2.02</td>
<td>1.07</td>
<td>0.72</td>
<td>0.60</td>
<td>0.46</td>
<td>0.45</td>
<td>0.47</td>
<td>0.44</td>
<td>0.37</td>
</tr>
<tr>
<td>6. Early retirement</td>
<td>0.11</td>
<td>0.15</td>
<td>0.19</td>
<td>0.16</td>
<td>0.16</td>
<td>0.17</td>
<td>0.09</td>
<td>0.04</td>
<td>0.01</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>2.79</strong></td>
<td><strong>1.83</strong></td>
<td><strong>1.35</strong></td>
<td><strong>1.13</strong></td>
<td><strong>1.07</strong></td>
<td><strong>1.01</strong></td>
<td><strong>0.96</strong></td>
<td><strong>0.87</strong></td>
<td><strong>0.86</strong></td>
</tr>
<tr>
<td>Active measures (1 – 5)</td>
<td>0.66</td>
<td>0.61</td>
<td>0.43</td>
<td>0.37</td>
<td>0.44</td>
<td>0.39</td>
<td>0.40</td>
<td>0.39</td>
<td>0.47</td>
</tr>
<tr>
<td>Passive measures (6 and 7)</td>
<td>2.13</td>
<td>1.22</td>
<td>0.92</td>
<td>0.76</td>
<td>0.63</td>
<td>0.62</td>
<td>0.56</td>
<td>0.48</td>
<td>0.38</td>
</tr>
</tbody>
</table>


\textsuperscript{15} There are employers in seasonal industries that seem to exploit this rule for bridging the idle periods.
ALMPs

ALMPs were introduced already during socialism to hide unemployment, when ideology found it unacceptable. That is, one continued with the same programmes throughout the transition though modified for the new conditions. Still it has been questioned whether the ALMPs are appropriate to the nature of the Hungarian unemployment, since they were invented to manage frictional and structural unemployment, while Hungarian unemployment today is the outcome of demand-deficiency. Nevertheless, it is one of the few transition countries, which has been continuously monitoring ALMPs. Training and retraining used to be the most far-reaching of the ALMPs but not the greatest in terms of expenditure. In the short run training might be less efficient as it mostly corrects for frictional and structural unemployment, and it has therefore been given less resources. In the first years of transition the most extensive ALMP in Hungary was short-time working allowance. Normally it covers workers who voluntarily undertake to work less, but this scheme was intended to encourage employers to deal with temporary employment difficulties not by dismissals, but by giving “part-time” work to their employees. Despite the low expenditures, workers and employers quickly lost interest and the number of short-time workers dropped significantly. Public works is another highly frequented programme, and has gone from only physical labour to including more qualified jobs, e.g. social services, health, education, and the protection of monuments.

In spite of the low retirement age, workers who are within five years of the official retirement age could receive early retirement pension. The employer has to pay an amount to the pension insurance, but can claim a subsidy from the employment fund. Since the decentralised funds take the consequences for those costs, one tries to transfer these cases to the preliminary pension financed by the solidarity fund. To ensure employment and training for the workers dismissed by large companies under liquidation, the labour market committee established employment companies. Without regional job creation programmes and possibilities for creating new enterprises the companies were though opposed. ”Since 1997, the Government has been operating labour market programmes which comprise individual labour market evaluation, job-clubs, personal development courses, communication training, supports for training and employment and a series of projects involving the assistance of NGOs.” (“Joint assessment of the employment policy priorities of Hungary”)

36
6.3.3 Poland

The Polish transition started in January 1990 with price liberalisation and stabilisation. The fears of continued soft budget constraints proved unjustified, and the Polish governments have been highly responsible and farsighted. The transition has though been recognised as steady but slow. The first years were associated with large decreases in GDP together with falling employment. (See Figure 4. & 5.) Despite the turn in output, which stabilised in mid–1992, employment kept declining. As the first Visegrád country, Poland reached the pre-transformation level of GDP in 1995. “The recovery of the economy was enabled by investment growth, expansion of exports and a rapid expansion of the private sector, which was quite extensive even before 1990.” (Adam, 1999, p. 28) In turn this contributed to an increase in labour productivity and economic growth. The private sector accounts for a considerable part of Polish GDP, and of employment. Despite very small investments, labour productivity increased with a smaller number of workers. This was possible as the firms were initially below their output frontier and can be called “dis-hoarding”. After the first years, productivity continued to rise but then aided by higher investments, which created a temporary decline in the unemployment rate.

A wage control was set up in the 1980s in the form of tax penalties for violating the set wage growth limits. The tax had a negative effect on production and productivity, and contributed to the widening of wage differentials. First, enterprises that wanted to expand their production by increasing the workforce had to pay the tax. Second, enterprises could not reward workers who worked hard, if they could not reduce the workforce at the same time, and thus there was no incentive for enhanced productivity. Further, high redundancy payments imposed on firms provided a disincentive to mass lay-offs and to recruiting younger people. Together with an effective opposition to mass lay-offs by trade unions, the result has been a high youth unemployment rate and a stagnant unemployment pool characterised by moderate inflows and low outflows.
Labour market situation

“In Poland the unemployment rate jumped from virtually zero at the beginning of 1990 to 15.7 per cent (registered unemployment) and 14.9 per cent (Labour Force Survey) at the end of 1993. This huge increase put Poland among the countries in the world with the highest unemployment rates.” (Góra, 1997, p. 115) Sectoral change has foremost affected agricultural and industrial employment, and those remain sectors that will undergo further reduction of labour. Two trends affecting the labour market have appeared in Poland: an increase in the population of working age; further a decrease in both employment and the labour force. The increase in non-employment was predominant, and people were flowing out of the labour market. A significant number of workers took the opportunity to retire before they reached regular retirement age. Beside that, the number of long-term unemployed reached a stable level early in the transition, and has since that time been about 45 per cent of total unemployment. The position of women in the labour market has proved to be worse than that for men. Most remarkable is the difference between the sexes in non-employment.

Institutional framework

The organisational structure of the public employment service (PES) was developed in 1990 and 1991. The PES is directly subordinated the Minister of Labour and Social Policy. The PES operates at three levels: a national, a regional, and a local level. Most of the tasks are the
responsibility of the Local Labour Offices. In particular they register the unemployed, decide on unemployment benefit eligibility in particular cases and also pay the benefits. The offices are often understaffed and with a constant shortage of financial resources, which limits their capacity to implement active labour market programmes. Registration procedures are regulated by law, but initially deregistration was failing and the labour offices did not empty their registers on a regular basis. To start with, administration of the unemployment benefit system was regarded as the most important responsibility of the labour offices. While passive income support schemes for the unemployed were mainly used in the beginning of the transition, the use of the two types of LMPs are currently more equal, though diminishing.

PLMPs

“Labour market policies must be seen in the context of the overall economic development challenges facing Poland. Poland’s over-riding objective is to achieve high levels of sustainable growth...” (“Joint assessment of the employment priorities in Poland”) This is the aim together with wishes to create a flexible labour market structure.

With the initial version of the law of employment, there was a clear incentive to register, as virtually everybody without work and registered at a labour office was granted unemployment benefits. The initial generosity of the unemployment benefit regime is seen by many as an important contributing factor to the increase in registered unemployment at the beginning of the transition process. Since the beginning of 1992 the generosity of the unemployment benefit system has been reduced substantially (See Table 3.), and changed into a flat-rate unemployment benefit, that is, not related to previous earnings. The entitlement period went from being open-ended to 12 months in regular cases and 18 months in special cases (mostly concerns people who live in areas officially recognized as economically depressed). A further important change was the introduction of a 3-month waiting period for school leavers. To reduce the negative social impact of the reduced length of benefit eligibility introduced in 1992, free health services were introduced for all unemployed. This applies whether or not they are still claimants and also for their families. Free health care for all unemployed creates an incentive to register and tends to inflate the unemployment rate, and especially the rate of long-term unemployed. However, the duration has somewhat changed since the reform in 1992, and today the duration of entitlement to benefit is related to the unemployment in the local labour market:- six months in areas with unemployment below...
the national average, one year in areas with unemployment between one and two times the average, and eighteen months where unemployment is more than double the national average.

The change in the unemployment benefit was expected to have an impact on the search intensities of the unemployed. A Labour Force Survey provides data that indicates that the distribution of reservation wages by duration of unemployment is almost flat. This suggests that some of the unemployed might have chosen their situation voluntarily, as the wage level is much above both the minimum wage and the level of unemployment benefits. However a study using Polish data showed that the effects of reducing the unemployment benefit entitlement period from an unlimited period of time to generally 12 months had no significant effects on unemployment durations. The results are similar to others for the Visegrád countries.

Table 3. Public expenditures as a percent of GDP for Poland

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public employment services</td>
<td>0.02</td>
<td>0.01</td>
<td>0.01</td>
<td>0.02</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>2. Labour market training</td>
<td>0.03</td>
<td>0.03</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>3. Youth measures</td>
<td>0.09</td>
<td>0.07</td>
<td>0.08</td>
<td>0.10</td>
<td>0.09</td>
<td>0.10</td>
<td>0.09</td>
<td>0.07</td>
<td>0.08</td>
</tr>
<tr>
<td>4. Subsidised employment</td>
<td>0.20</td>
<td>0.24</td>
<td>0.21</td>
<td>0.16</td>
<td>0.19</td>
<td>0.16</td>
<td>0.10</td>
<td>0.06</td>
<td>0.05</td>
</tr>
<tr>
<td>5. Unemployment compensation</td>
<td>1.72</td>
<td>1.77</td>
<td>1.88</td>
<td>1.77</td>
<td>1.10</td>
<td>0.55</td>
<td>0.64</td>
<td>0.81</td>
<td>1.01</td>
</tr>
<tr>
<td>6. Early retirement</td>
<td>0.15</td>
<td>0.10</td>
<td>0.05</td>
<td>0.05</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>2.25</strong></td>
<td><strong>2.27</strong></td>
<td><strong>2.27</strong></td>
<td><strong>2.14</strong></td>
<td><strong>n.a.</strong></td>
<td><strong>n.a.</strong></td>
<td><strong>n.a.</strong></td>
<td><strong>n.a.</strong></td>
<td><strong>n.a.</strong></td>
</tr>
<tr>
<td>Active measures (1 – 5)</td>
<td>0.38</td>
<td>0.39</td>
<td>0.34</td>
<td>0.32</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Passive measures (6 and 7)</td>
<td>1.87</td>
<td>1.87</td>
<td>1.93</td>
<td>1.82</td>
<td>1.10</td>
<td>0.55</td>
<td>0.64</td>
<td>0.81</td>
<td>1.01</td>
</tr>
</tbody>
</table>

Sources: The OECD employment outlook – July 1997 & June 2001

**ALMPs**

In Poland the labour fund is financed by taxes and government subsidies. Since the PLMPs and the ALMPs are both financed from this fund, the residual amount available for ALMPs has been very small. ALMPs require both financial resources and some experience in the implementation of policies, but both of these prerequisites were hardly available in Poland in the early 90’s. On average the expenditure on active employment policies accounted for about
1/5 of total expenditure in the first years of transition, but has since then been successively declining. (See Table 3.)

Although limited, labour offices have been able to introduce a set of activities. Training courses are offered to those who do not have any skills, have skills that are out of demand, or have lost their ability to use their previous skills. Training should however not be a substitute for vocational training. In Poland job subsidies are called intervention works. Labour offices refund a part of the compensation to employers who decide to hire unemployed persons. If the employer decides to keep the worker in the firm after the period is completed, additional funding is available from the labour office. Intervention works are mostly aimed at the following three vulnerable groups: long-term unemployed, school-leavers, and women. Due to the manual labour character of public works, women have been less represented and are therefore offered intervention works. Both public and intervention works give the unemployed the status of employees. After six months of working on a scheme the participants can claim unemployment benefit again. However this creates a feedback between the active and passive policies. Even though reducing the number in PLMP is a target of the active schemes, the PLMPs will need more resources the more resources are spent on active programmes. Intervention works and public works often have seasonality in the labour flows.

After the first phase of transition ALMPs have now come to play a more important role for Poland. The microeconometric analysis in a study of ALMPs in Poland reveals that programmes are not particularly well targeted at the problem groups in the labour market. That is, women and people with basic vocational education do not receive enough attention. As to the effectiveness of ALMPs, the study shows that former participants cannot expect to find employment more easily than their peers who have been unemployed but have not been in a programme. (Puhani & Steiner, 1997, p. 209) Subjective evaluations of former participants also suggest that ALMPs have not improved their chances of finding a job.

7. Comparative analysis of design and outcome

In earlier sections I have discussed the economic background of the Visegrád three at the start of the transition and discussed the particular challenges that the transition process poses to the functioning of labour markets. Furthermore, I have shown the central role that passive as well as active LMPs can play in the adjustment process during transition. The design of LMPs can,
however, vary and is likely to affect employment outcomes. Section 6 shows that the LMP design did indeed vary between the Visegrád three. Here I tried to characterize the LMP design chosen by each country and the adjustments that were made over time. Against this theoretical and empirical background, I now proceed to a comparative analysis of employment outcomes and LMP design in the three countries.

In this section I start by presenting the labour market situations, with focus on the evolution of unemployment. Sub-section 7.2 entails a discussion of the impact of macro-economic factors during transition and the post-transitional years. Eventually time has come to compare the three countries in question with respect to labour market policies. That is, sub-section 7.3 analyses the passive labour market policies, and sub-section 7.4 deals with the active labour market policies.

7.1 Comparative employment evolution

The level of unemployment provides a fairly good measure of the labour market situation. The three countries analysed in this paper have experienced extensive fluctuations since the start of the transition. It is thus hard to determine whether they have reached their natural rate of unemployment, but the answer is probably no. Despite a slow-down in structural changes after the transition, the Visegrád three all still have sectors that need further restructuring.

Until the transition was initiated, the Visegrád three showed zero unemployment in labour force statistics. Consequently, this was unsustainable to keep for the emerging market economies. Hungary and Poland underwent a great transformation and reached a two-digit unemployment rate within the two first years. (See Figure 1.) CR could keep a low average level of 4% unemployment until 1997. Ever since a maximum of 12% reached in 1993, the rate in Hungary has successively declined; the unemployment rate was halved to 6%. Poland has remained at a high level of unemployment, except for a decline in the late 90s; the unemployment rate will soon exceed 20%. When the other countries experienced falling unemployment rates in the second part of the 90s, the number of unemployed rose in CR. However, CR has recently succeeded in stabilising its economy. At the same time, the decline in employment has been greater than the growth in unemployment. Table 4. presents data on the labour force participation (LFP), and one can observe a negative tendency for the Visegrád three, though more emphasized in Hungary. The working-age population has in turn
successively been increasing, and in terms of number the decline in LFP is in reality greater. The outflows from the LFP have outweighed the inflows. This can be due to several causes; the liberal access to early retirement and disability pensions, discouraged workers leaving the workforce, and/or extensive informal sectors absorbing workers.

Table 4. Labour force participation rate
(% of total population from 15 – 64 years old)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>73.6</td>
<td>72.7</td>
<td>73.5</td>
<td>73.2</td>
<td>73.1</td>
<td>72.4</td>
</tr>
<tr>
<td>Hungary</td>
<td>n.a.</td>
<td>65.1</td>
<td>60.2</td>
<td>58.0</td>
<td>57.5</td>
<td>59.2</td>
</tr>
<tr>
<td>Poland</td>
<td>68.4</td>
<td>70.0</td>
<td>68.1</td>
<td>67.0</td>
<td>66.2</td>
<td>65.6</td>
</tr>
</tbody>
</table>


Normally, the definition of long-term unemployment is duration of unemployment that is over 12 months. This coincides often with the expiration of unemployment benefits. Thereafter, active labour market programmes designed for long term unemployed might follow. As soon as one year had passed after the start of transition, the share of long-term unemployed began to rise. Table 5. shows the composition of unemployment and it is clear that unemployment that lasts more than 12 months is the single greatest share. It is possible to observe some fluctuations that follow the unemployment rate, e.g. a decline of the share of long-term unemployment in Poland in 1999 and in Hungary in 2003. CR has not yet managed to counteract their increasing long-term unemployment.

Table 5. Long-term as share of total unemployment (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>1996</th>
<th>1999</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6&lt;months&lt;12</td>
<td>18.4</td>
<td>21.1</td>
<td>24.8</td>
<td>19.6</td>
</tr>
<tr>
<td>&gt; 12 months</td>
<td>18.5</td>
<td>31.3</td>
<td>37.1</td>
<td>50.7</td>
</tr>
<tr>
<td>Total</td>
<td>37.8</td>
<td>52.4</td>
<td>61.9</td>
<td>70.3</td>
</tr>
<tr>
<td>Hungary</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6&lt;months&lt;12</td>
<td>24.1</td>
<td>20.8</td>
<td>20.9</td>
<td>22.6</td>
</tr>
<tr>
<td>&gt; 12 months</td>
<td>33.5</td>
<td>54.4</td>
<td>49.5</td>
<td>44.8</td>
</tr>
<tr>
<td>Total</td>
<td>57.6</td>
<td>75.2</td>
<td>70.4</td>
<td>67.4</td>
</tr>
<tr>
<td>Poland</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6&lt;months&lt;12</td>
<td>25.6</td>
<td>23.8</td>
<td>22.3</td>
<td>21.6</td>
</tr>
<tr>
<td>&gt; 12 months</td>
<td>39.1</td>
<td>39.0</td>
<td>34.8</td>
<td>48.4</td>
</tr>
</tbody>
</table>
In the Visegrád three a reallocation of labour occurred from agriculture and industry to services sector. If one breaks down employment by sector, the Visegrád three represent different combinations of the two former dominating sectors. The fastest growing sector, even in numbers of employed, has been the service sector. The service sector has been able to absorb some of the redundant workers from the industrial and agricultural sectors. Still, the structural changes within industry and agriculture have caused high rates of unemployment, with a great share of long-term unemployed. The conditions for finding a new job require retraining, and foremost willingness to move once a job opportunity arises. Even though Poland has cut down the farming sector, it continues to be unproportionally large (about 18% of all activity compared to CR and Hungary with about 5%) in terms of employment. The same applies for the industrial sector, which has been restructured to enhance labour productivity. There remain structural problems with lagging labour hoarding, foremost in the industrial and agricultural sectors, but to a much smaller extent.

Table 6. shows that the populations of the Visegrád three have almost stagnated, and even receded (CR and Hungary). Data reveals a demographic change; a significant decline of persons under 15 years, and an increasing old-age population (> 65 years). The working-age population continues to increase, but at a slower pace.

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>1996</th>
<th>1999</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>10326.5</td>
<td>10324.4</td>
<td>10283.1</td>
<td>10245.7</td>
</tr>
<tr>
<td>Hungary</td>
<td>10300.9</td>
<td>10178.6</td>
<td>10055.9</td>
<td>9922.8</td>
</tr>
<tr>
<td>Poland</td>
<td>38352.1</td>
<td>38639.3</td>
<td>38681.5</td>
<td>38622.1</td>
</tr>
</tbody>
</table>

7.2 Macroeconomic factors

The first steps of transition were focused on liberalisation and macroeconomic stabilisation. Countries with low inflation and low indebtedness were given good starting positions. This was the case for CR. Hungary managed to reduce inflation, but had relatively the greatest foreign debt. Poland suffered from galloping inflation, but got a debt relief to be helped out of the recession. Due to the large number of reforms together with privatisations that should start functioning, the Visegrád three experienced negative growth for some years. A large drop in output and lagging budget deficits contributed to the recession. With exception for CR, one can see the initial points of GDP that were above the 1995 level in Figure 5. The recession had been deeper for Hungary and Poland than for CR. However, in the third year of transition growth started to turn. Hungary had chosen a gradualist strategy of transformation, while Poland and CR preferred shock treatments, to obtain a fast recovery. Thanks to extensive structural changes, Hungary and likewise Poland have managed to maintain steady growth in the second part of the 90s. Unlike its peers, CR’s growth slowed in 1996, and this was attributed to continued structural difficulties. The Czech recession dated back to failure of early reforms, among them the “voucher” privatisation. This had an explicit effect on the unemployment rate, which rose by 3-4 % percentage points in a couple of years. (See Figure 1.) By means of a programme of economic measures, positive economic growth for CR could be observed in 1999/2000. In Figure 5. one can notice a significant change in the slope of the Polish GDP curve, which occurred in 2000. The economic slow-down was probably caused by increasing trade and current account deficits, high inflation, and further structural changes in industry.

---

6 The Czech growth curve in Figure 5 follows the same path as those of Hungary and Poland, i.e. it has an initial point above 100 at the start of the transition.
Labour productivity is further a measure of the labour market situation. With inherited low labour productivity, mass dismissals were a fact, when central planning was abandoned. Due to restricted wages, redundant workers could be kept to postpone unemployment. Labour hoarding has been avoided by gradual structural changes in the Visegrád three. A possible remedy for labour hoarding is investments and demission of workers. Thus, the rate of unemployment indicates to some extent the severity in combating labour hoarding. The slow down of the Czech economy was partly caused by labour hoarding, connected to low real wages and the postponed restructuring of certain sectors. In Poland, “dis-hoarding” of labour has evolved. That is, enterprises could increase their labour productivity and their output, with a smaller number of workers.

7.3 Comparative analysis of PLMPs

In the first year of transition, the duration of unemployment benefits was hardly restricted and offered a good replacement of the former wages. The redundant labour force that became unemployed had few incentives to job search. It was before the Visegrád three set out their legislative frameworks of employment policies. Consequently, the first year of transition offered unemployment insurance that was set without prospect of the full extent of future expenditures. The generosity of the replacement rate and the duration of benefits resulted in
an emergence of a large number of registered unemployed. Poland experienced the greatest outflow from the labour market, and they offered almost everyone without work a possibility to register and touch unemployment benefits. The generous benefit system captured a great amount of the extensive outflow and offered besides that early retirement. Budgetary restraints soon called for changes of the unemployment benefit eligibility, since the number of unemployed increased drastically. In 1991, the countries in subject presented an employment act together with public employment services, that would provide income support and active assistance to job search. The following changes were introduced in the Visegrád three; in CR the maximum duration of insurance was halved in 1992 from 12 to 6 months, the replacement ratio was lowered; in Hungary the benefit entitlement was reduced from two to one year in 1993; in Poland the entitlement period dropped to 12 months from once being open-ended, and changed into a flat-rate unemployment benefit. It is somewhat difficult to interpret the effects of the unemployment benefit measures in Table 1. – 3. Expenditures in 1993 – 1995 appear to increase in accordance with the unemployment rate in CR and Poland. However, the sudden fall in unemployment compensation in Hungary from 1993 to 1994 could be derived from reduced duration, or some other, to me, unknown explanation.

Furthermore, the unemployment benefit schemes of the Visegrád three offer some variations that are presented here. The short entitlement period in CR and the low rate of unemployment kept down the expenditures on passive measures in the beginning. Due to the early retirement scheme being covered by social insurance funds, the share of expenditure has remained relatively low. The increasing number of unemployed, starting in 1997, eventually altered the expenditures of unemployment compensation. The Czech unemployment compensation rates show a pro-cyclical fluctuation during the time span observed. Hungary has been exposed to the highest rates of long-term unemployment. This has provided large cohorts with exhaustion of benefits. Unemployment assistance was soon introduced in order to follow, when the entitlement of unemployment insurance ceased. It has thereafter become the most common form of social insurance. The following factors have made it possible to restrain expenditures on passive measures; falling unemployment rate (including long-term unemployment), shorter duration, lower replacement ratio, and a transfer of the early retirement pension to the pension insurance system. The restraints of the Polish unemployment compensation in 1992 were compensated by access to free health services for all unemployed and their families. Poland is the only Visegrád country, which differentiates the duration of entitlement to benefit. The decisive factor of duration is the unemployment rate in the local labour market compared to the national average. The duration varies between
six months in “low”-unemployment areas to 18 months in areas with substantial problems of unemployment.

Despite significant sectoral changes in the Visegrád three, the relative share of industrial and agricultural workers is an important factor determining regional variations in employment rates. Hence, the share of unemployment benefits provided to rural areas is relatively greater than the share going to urban areas. Local labour offices in rural areas are assigned more resources for both PLMPs and ALMPs. At the same time, the cash transfers from unemployment benefits mostly represents a greater purchasing power than in urban areas. Therefore, one can assume that incentives for remaining unemployed prevail in rural areas; the opportunity cost of working is higher and reservation wages increase. Among the Visegrád three, Poland has suffered most from regional asymmetries.

7.4 Comparative analysis of ALMPs

In spite of widespread programmes presenting employment strategies, the Visegrád three belong among the countries in OECD with the lowest public expenditures on active measures. The expenditures on ALMPs tend to fluctuate with the unemployment rate to a smaller degree than the PLMPs. In this case, a comparison with the duration of unemployment in Table 5. is more relevant than with the unemployment rates in Figure 1. ALMPs even act in a counter-cyclical manner owing to a trade-off between PLMPs and ALMPs for aggregate expenditures on labour market measures. The administration of ALMPs is rather costly, but entails at the same time some of the job broking. ALMPs were carried out immediately in connection with the transition. However, Hungary had already introduced active measures during their market-socialism. Hungary is, as well, the Visegrád country with the highest share spent on ALMPs. It is difficult to determine whether CR or Poland comes next, due to non-available data for expenditures on active measures in Poland from 1997 to 2001. Apart from CR, Hungary and Poland follow a negative trend with declining expenditures over the time period referred to in Table 1. – 3. The increasing costs of ALMPs in CR are probably related to the growing rate of unemployed workers.

ALMPs should be designed in accordance to special features of the varying labour market situations. The programmes have a non-existent, or perhaps even a negative, effect on

7 The expenditures on active measures even surpassed those on passive measures in 2001 (Table 2.)
labour demand. Nevertheless, they may stimulate labour supply in times of structural changes. Despite difficulties in targeting problem groups effectively, this is the aim of ALMPs. The target groups of unemployed vary among the Visegrád three; long-term unemployed are given high priority in all of the three countries, youth unemployment is further a crucial objective in ALMPs, especially in Poland, Romas constitute a minority group in both CR and Hungary, and call for active measures.

The ALMPs vary to some extent between the Visegrád three. The differences will be presented in this following section. CR had means to spend on ALMPs in the start of the transition, despite the low rate of unemployment. This constituted a preventive action for coming structural changes. Spending on job broking was relatively high and gave the conditions for maintaining a high outflow from unemployment. Job creation programmes have received a substantial share of the resources and are aimed at selected groups of job seekers that are offered “socially purposeful jobs”. Training and retraining have continuously been given low priority. Creation of new jobs has been one of the aims of the Czech active programmes. This has been facilitated through support to development of SMEs. Through investments, tax incentives, and provision of consulting and training for SMEs and their staffs, the Government wants to develop entrepreneurship. All kinds of ALMPs are represented in Hungary and are allocated more resources. This implies thus a greater variety of programmes such as; an attempt to create short time works and employment companies, an extended version of public works, and eventually programmes that comprise individual guidance counselling. Since the Polish ALMPs are composed of the residual amount of the aggregate expenditures on LMPs, the choice has therefore been rather limited. The target groups for subsidised employment, known as intervention works, have been long-term unemployed, school-leavers, and women. These groups have all a higher representation among the unemployed8. Furthermore, the substantial agricultural sector has a great seasonal use of public works.

---

8 Even higher among the "non-employed", if they are divided into subgroups
8. Summary

This final section summarizes the analysis and presents the main conclusions of this paper. The transition process has involved far-reaching structural changes for the former centrally planned economies, including the Visegrád three. By following the neo-liberal strategy for transformation, the Visegrád three turned into market economies at a rapid pace. The economic reform required a carrying out of the three “pillars” of neo-liberalism: stabilisation, liberalisation, and privatisation. This resulted in substantial macroeconomic imbalances with a great fall in output and excessive inflation. The decline in aggregate demand inevitably led to a great outflow of workers starting in 1990. Together, the Visegrád three faced the problem of reallocating labour, due to structural changes. The labour market situation changed dramatically and implied a decline in labour demand and an excessive labour supply. To reach equilibrium, i.e. the natural rate of employment, required foremost a macroeconomic recovery. Nevertheless, labour market policies would also play a central role in combating unemployment.

LMPs constitute a framework for the functioning of labour markets. Passive and active LMPs were introduced at an early stage of transition, but with varying design. Each country has set out individual institutional frameworks of employment policies. Due to the great outflow of workers, the number of unemployed increased rapidly together with an extensive amount exiting from the labour force. Many workers, close to retirement age, embraced the possibility of an early pension. Within the first years of transition, the Visegrád three had all reduced the duration of unemployment benefits, owing to budgetary restraints. Throughout the time span observed (1989 – 2004), the LMPs (passive as well as active) have undergone substantial adjustments. To sum up, I will describe the most important outcomes of the labour market evolutions in CR, Hungary, and Poland.

To start with, CR experienced a successful transition to market economy, especially concerning stabilisation and liberalisation. Furthermore, CR tried out privatisation of state-owned enterprises and formerly nationalised property, and restitution to the Czech population and to the former owners. Despite a relatively weak output recovery, CR managed to keep
down the unemployment rate. The labour turnover was high, but newly created vacancies absorbed the jobless persons. This resulted in the lowest unemployment rate among the Central and Eastern European countries until 1997. But a deep recession would follow, accompanied by a strong decline in employment. The structural changes had failed, and further reform was necessary. Due to the initial low unemployment, CR had been able to maintain the aggregate expenditures on LMP at a low level. Job broking was the most successful achievement among active measures together with programmes aimed at promoting SMEs. Both active and passive LMPs were provided more resources after 1997, owing to the increasing number of unemployed. Growth has now recovered slowly together with a slight decline in unemployment.

Hungary had many of the requirements to perform well when turning into market economy. Unlike CR and Poland, Hungary chose the path of gradual transformation. This implied a rather slow but stable growth in GDP. Nevertheless, the unemployment rate rose substantially during the first years of transition, and reached 12% in 1993. Thereafter the economic recovery started and employment increased. Hungary is one of the few transitional countries, which have experienced a sustainable increase in employment since then. Hungary used to pay out the greatest share of expenditures on LMP measures among the Visegrád three. ALMPs were even introduced before the transition, and have thereafter remained central. The design of Hungarian ALMPs is extensive and includes a wide range of programmes. Furthermore, Hungary has the lowest labour force participation rate of the Visegrád three. Increasing the LFP is a major task for Hungary, which will require a thorough review of the benefit systems, and especially the pension system.

The average income has been substantially lower in Poland than in the other Visegrád three. A successful recovery of aggregate demand has enabled an extensive growth in GDP, which has diminished the gap in income between the three countries. Poland became the first Visegrád country to reach its pre-transition level of GDP in 1995. Since the start of transition, high and sustainable levels of growth have constituted the over-riding objective for Poland. Structural changes in agriculture and industry demanded for great labour shedding. The redundant workers flowed into unemployment or out of the labour force. Initially, generous unemployment benefits implied incentives to register as unemployed. The Polish unemployment rate reached the highest level among the OECD countries. The high number of unemployed asked for extensive aggregate expenditures on unemployment compensation. The residual amount left for active measures has been relatively small. The design of ALMPs has therefore become insufficient, and has not been able to function effectively. Poland has
recently faced new, difficult challenges owing to a slow-down in growth and a 20% unemployment rate.

*Future evolution in the Visegrád three*

The Visegrád three joined the European Union on May 1, 2004. A “second” transformation started including further structural reforms. This will affect the Visegrád three, conceivably, to an even higher degree, than the “first” transition. The EU accession countries will encounter a labour market situation, where they will have less independence, but at the same time greater possibilities. The enlargement process has required macroeconomic stability to promote investment and growth, including growth of employment. The Visegrad three have all presented an employment policy review with “the joint assessment of employment priorities for each country in subject”, before entering EU. I will finish this paper by quoting some of the coming goals for labour markets, in connection with the enlargement; “The fundamental challenges, in the field of employment, consist, first, in recognising that labour markets should reflect the needs of a dynamic market economy as part of a single market, in particular whether labour is mobile, adaptable and skilled. The second challenge is to have policies and appropriate institutions that support the development of a flexible labour market. This includes the need to promote a forward-looking approach to industrial restructuring to adapt knowledge-based economies and to face the impact of demographic change.” (“Joint assessment of the employment priorities in Poland”)
9. References

9.1 Literature


Adam, J. (1999) Social Costs of Transformation to a Market Economy in Post-Socialist Countries: The Cases of Poland, the Czech Republic and Hungary. Basingstoke; New York, Palgrave Macmillan


9.2 Websites

Diamantopoulu, A. & Komolowski, L., “Joint assessment of the employment priorities in Poland”
2004-05-02

Diamantopoulu, A. & Spidla, V., “Joint assessment of the employment policy priorities of the Czech Rebublic”
2004-05-02

Diamantopoulu, A. & Stumpf, I., “Joint assessment of the employment policy priorities of Hungary”
2004-05-02

IFS MAY 2004 – International financial statistics
2004-05-18

OECD – Labour force statistics 1982-2002
http://80ariel.sourceoecd.org.ludwig.lub.lu.se/vl=4205587/el=19/nw=1/rpsv/~6682/v2003n19/
s1/p11
2004-05-18