

Reconciling labour flexibility with social cohesion – The experiences and specificities of central and eastern Europe

Trends in social cohesion, No. 17

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PREFACE

How to reconcile labour flexibility with social cohesion? The Directorate General of Social Cohesion of the Council of Europe already put this topical question on the agenda of its annual forum in 2005. And the subject gained more momentum and importance in 2006 when taken up by the European Union presidencies. The European Commission has recently proposed a green paper on labour law originally entitled “Adapting labour law to ensure flexibility and security for all” and is planning a communication on flexicurity for spring 2007. The Council of Europe contributes to this debate by inviting people to look at possible answers from a rights-based perspective. In its approach to social cohesion, it proposes principles that should govern this reconciliation.

However, this question does not only concern “old” EU member states, among which we can find countries such as Denmark or the Netherlands which have very successfully addressed this challenge. The increase in flexibility in labour relations since the fall of the Iron Curtain has been even higher in central and eastern European countries. Obviously, knowledge of the effects on social cohesion and ideas on how labour flexibility could be designed to be more compatible with employment security are of much interest for central and eastern Europe too. Paradoxically, the discussion of the problem and of solution strategies has been mostly limited to some western European countries.

The Council of Europe with its 46 member states from the whole European continent can contribute to closing this gap. In fact, the 2005 forum has confirmed the necessity to extend the usual analyses and to take into consideration the specificities of these countries and their socioeconomic situation when discussing the challenge of labour flexibility and especially when thinking about solution strategies. The needs of flexibility and security seem to be systematically different in transition economies and consequently take another place on the political agenda. Solution strategies become worthless without taking into consideration different realities. One size cannot possibly fit them all. It became clear that more knowledge on possibilities to reconcile flexibility and social cohesion in these countries is needed.

Therefore, we have decided to publish – with the help of academic experts and our colleagues from the International Labour Organization, with whom we have joined forces on employment questions in South-Eastern Europe

for years, and the support of the Belgian Federal Government – a special volume on reconciling labour flexibility with social cohesion in central and eastern Europe. This publication gives insights into specificities of central and eastern European countries with respect to labour flexibility and social cohesion and proposes ideas for solutions adapted to this context.

I hope this work will inspire policy makers on the European continent to look for development strategies that unite flexibility and security and in which social cohesion is a factor of competitiveness.

Alexander Vladychenko

*Director General of Social Cohesion
Council of Europe*

INTRODUCTION

When addressing the question of possible accommodations between labour flexibility and social cohesion as a challenge for Europe, the characteristic realities of central and eastern Europe need to be considered. This is due to the fact that in these regions flexibility and the transformations of the national social and institutional systems as a whole have materialised chiefly under pressure from outside agencies (the World Bank, the IMF, the European Union, the OECD), whereas in western Europe they are more “policy-led” (cf. J. Kochanowicz’s contribution).

In fact the socialist economies caused chronic manpower shortages: overt unemployment was unknown, the employment rate was high, and wages did not reflect individual productivity but aimed at egalitarian incomes. With the radical transformations resulting from the transition to market economies, shortages vanished, taking job security with them. Yet, paradoxically, this is seldom mentioned in the debate on the future model for reconciling labour flexibility with social cohesion, and the available information is relatively sparse.¹

The contrasts with the processes of transformation at work in the countries of western Europe are such that it is time to dispense with the idea of a single strategy. Indeed, the proposed reconciliation absolutely must take East-West differences into account, and this volume sets out to open avenues for doing so. It must therefore be emphasised at the outset that in central and eastern Europe we encounter not one reality but different realities in different states, to match the disparity of the communist systems and the differing prior patterns of development. Now, as in the case of the western European social models, groups of countries with similar situations can be singled out: the states of the Community of Independent States (CIS), the Visegrad countries, the Baltic countries, the countries of South-Eastern Europe and the Balkan countries (except Slovenia). That is why this study presents typical examples: Poland, Estonia, Russian Federation, Bulgaria, Croatia and Turkey, which differs from the others namely because it has no communist past.

1. See, for example, Wallace, C. (2002) “A critical review of literature and discourses about flexibility”, HWF Research Report No. 1.

Nearly all these countries in fact went through what Janos Kornai called – referring to Karl Polanyi – “the great transformation”² from a socialist system with a command economy to a market economy, incurring profound social changes reflected in the novel forms of work distribution.

This volume is thus arranged in two parts:

1. Broadening perspectives so as to address, in a pan-European context, the questions of concepts and issues surrounding labour flexibility and social cohesion;
2. Comprehending the specificities of certain realities in central and eastern Europe, including Turkey.

Labour flexibility, precariousness and social cohesion

From the rigidity of the communist system to complete uncertainty

Before 1990, companies in central and eastern Europe were shielded from the global market: production and distribution were centralised and concentrated on national markets, with the allocation of work highly regulated and unconnected to the level of productivity. When the Berlin Wall came down, this scheme vanished: a large number of the wage earners changed jobs within the years which followed. The opening up of national economies saw the excessive demand for manpower supplanted by the intensification of productivity. Technology became crucial to the survival of companies which formerly had little incentive to innovate. The extremely rigid framework gave way to a system in which nothing is assured in advance. Everything that overbearing authorities and bureaucracy had stiffened to rigidity then became malleable, risky and insecure through the influence of market forces, competition, and civil rights guaranteeing more freedom of movement. Moreover, the comparatively generous social guarantees could no longer be preserved: the socialist state was no more. The introduction of labour flexibility and a reduction in social protection were seen as inescapable in adapting to the market system. Kochanowicz recalls the extent of these transformations in his article, emphasising that the former

2. Title of his address as President of the International Economic Association (IEA) at the 14th IEA world conference in Marrakesh on 29 August 2005.

communist countries had to adjust overnight to the market economy, and not only that. Their shock therapy also consisted of a leap into a globalised capitalist world that has caused upheaval in the structures of social and economic organisation in western Europe as well.

Today, per capita incomes are still appreciably lower than in western Europe, the disparities are wider, poverty and exclusion are increasing and unemployment is a problem for all generations. Flexibility measured by the employment protection index (OECD) has risen in just a few years to near the level of the most flexible countries in the West and has even outstripped the flexibility of the old European Union of 15 members.

But even flexibility often takes different forms. In Russia and in the Community of Independent States, flexibility is neither quantitative nor functional, but affects wages. As explained in the contribution by Vladimir Gimpelson, this model, which thanks to its versatility served Russia well while managing the early years of the transition, induced poverty among the working population and was a hindrance in reallocating workers to new jobs and consequently in finding a sustainable path for growth.

Furthermore, the informal economy and illicit, non-contracted employment are also patterns of labour flexibility that do not fit into any regulatory framework – as well as giving an indication that the extent of flexibility is to be determined only by assessing the degree of law enforcement. As Raul Eamets contends in his article, the employment protection index in Estonia is the same as in western Europe, but the rotation of labour is far more significant in the former because the legislative framework is not necessarily applied.

Nor, in a context of low income, is there any visible advantage in “choosing” flexibility, when it means working less (part-time). People want to work as many hours as they can to boost personal income. Flexibility is perceived as one more threat which further erodes an already precarious situation. Flexibility is “employer-led” and for virtually all men and women the ideal job is permanent and full time.³

By comparison with western Europe, where flexibility can be “chosen” in some cases to fulfil individual aspirations and is linked to the “family-friendliness” of companies, this is not yet an issue in eastern Europe. So, in a situation where the state reduces the protection of the family, women

3. Wallace, C., *op. cit.*

pay the highest price for flexibility in many of these countries (cf. Vladimirova contribution).

The sense of insecurity is very widespread at present, as expressed by all our writers, together with future fears linked with employment in particular. The phenomenon is amplified by a past where this type of challenge was unknown. Men and women were indeed socially programmed for a different world, as Katya Vladimirova also points out.

Different concepts and perspectives

The contrasts with western Europe begin with the way flexibility is apprehended. In academic literature, the concept changes virtually from one country to another. As Sabine Urban points out in her contribution, the perceived meaning of words, and their interpretations, are likely to generate country-specific divergences in attitude and behaviour. She explains these differences with precision. For one thing, collectivisation left such traces that, fifteen years after the destruction of the Berlin Wall, flexibility and social cohesion do not mean the same as in the West. Besides, she recalls, the two Europes plainly have different perceptions of reality if, as Douglass North,⁴ we take all types of formal and informal rules together, cultural heritage and values included.

Katja Vladimirova identifies differences that make the debate about reconciling flexibility and social cohesion so difficult. Individual values have gained the upper hand, leaving little room for a concept that resembles the old collective norms. As she sees it, the new system founded on self-interest and confrontation cancels out solidarity beyond the immediate family circle. Moreover, the past, when people suffered in the name of collective values, is perceived today as a weight to be cast off in order to develop personal forms of self-fulfilment. New identities are founded precisely on the break with that past and on the internalisation of individual values. This partly explains why the most liberal economic stances and a blind confidence in self-regulation of markets are also found in these countries.

However, not everyone has embraced these values; many people were socialised differently, let us reiterate. Indeed, the central and east European societies find themselves divided virtually into two groups living under

4. See North, D.C. (1990) *Institutions, institutional change and economic performance*, Cambridge University Press, Cambridge, MA.

different epistemological and axiological systems. The passiveness nurtured for decades, and the hampering of personal initiative, aggravate the risk of exclusion in a flexible market. For them, a world has collapsed. Lifelong work – as in the West – has been crucial in forming their identity. Nothing demonstrates this more clearly than the testimonies of those who used to work in the conglomerates. Although the ordinary workers only performed lowly tasks, they identified and defined themselves through their work. Perhaps even more than their western counterparts during the Fordian era, they felt part of a grand collective design: they did not see themselves as responsible for a simple task but as contributors to a project carried by all. Since the rewards were not expressed in material terms, as was the case for their colleagues in western Europe, they identified even more with these large complexes. The change that came over the world of work, and the advent of flexibility, took from them not only the stability of employment but also their professional identity and social role, which they have difficulty regaining by holding multiple jobs or opening micro-enterprises.

Labour flexibility, insecurity and social cohesion not only operate in different ways, they are seen differently. They take on another dimension than in western Europe: what is to be gained by reconciling them, and the ways to achieve this, are not the same.

The challenge of reconciling labour flexibility and social cohesion in central and eastern Europe

Specificities to be brought out and understood ...

What are the implications of reconciling labour flexibility and social cohesion in these contexts?

Considered in relation to the circumstances described above, reconciliation as such is found not to be an important political concern. Whereas notions like flexicurity are circulating in western Europe, it is much harder for them to gain a place in the political discussions of central and eastern Europe. As Kochanowicz demonstrates, it is difficult to address these issues and even to achieve a political consensus when societies are divided as to their perspective of things, and differing epistemological schemes operate side by side.

Broadly, what are the needs to be reconciled? These countries have all made enormous strides towards flexibility, as the indices show, but

performance in terms of reduction of unemployment is significantly lower than in western Europe. Despite a higher growth rate, unemployment is apparently stagnating or even soaring again, particularly in Bulgaria and Poland, which seems to contradict expectations. So what should be done? Should even more labour flexibility be introduced?

Alena Nesporova and Sandrine Cazes show in their article that on the contrary, flexibility may have passed an ideal threshold in central and eastern Europe and that insecurity is the main factor amplifying the problems in the labour market. They observe counter-cyclical labour turnover in these countries as opposed to pro-cyclical job tenure. Indeed, the very widespread sense of insecurity prevents effective allocation of work, because in these circumstances employees dare not quit their jobs, which are thus highly prized even if not in line with their aspirations.

By means of their empirical research, the authors prove that a negative correlation between social protection and unemployment cannot be demonstrated for these countries. In this way, they reveal that demands for greater flexibility to combat persistent unemployment remain unconvincing. They conclude that the deregulation policies did not improve labour market performance and even had adverse effects in some cases.

Their contribution suggests that the choice of a path for combating the increase in joblessness, other than just flexibility, and less insecurity could improve economic performance. Even from an economic standpoint, it seems worthwhile to move from flexibility towards flexicurity and towards reconciliation with social cohesion. Social benefits would obviously be added to these economic ones.

The forms of flexibility and security actually need to be reviewed. Neither the flexibility registered by indices nor the protection enshrined in law necessarily serve to attain their goal. As the example of the Russian Federation plainly shows, wage flexibility generates poverty and exclusion. Furthermore, the protection laid down in labour laws does not guarantee security because it is simply not enforced.

Here, we encounter a problem that cuts across many countries: inconsistency between law and reality. As Eamets puts it, a cynical view would be that in many countries there is flexicurity with flexibility in practice and security on paper. We are now touching upon a topic that decisively alters the possibilities for conciliation: the informal economy. According to estimates, up to 25% of the economy in central and eastern Europe is informal, as much as 40% in a few countries. Unregulated jobs and working conditions

mean that typical patterns of informal employment develop: multiple jobs (only one of which is normally declared), “family” jobs or bogus employers and “envelope wages” with securities and premiums outside the official rules. Thus flexibility stands on “inofficial” ground in that it creates ever more glaring inequalities between those who manage to enter the system and those left without protection. As demonstrated in the contribution of the former director of the Croatia Employment Service, Sanja Crnković-Pozaić, the time-honoured debate about the balance between flexibility and security and the ideas of flexicurity may be totally unsuited to a lawless context. To speak of reconciling flexibility with social cohesion makes no sense unless the reality of the informal economy is embodied in the break-out strategies, otherwise even more inequality could result.

There is another structural problem for reconciliation. Cheap labour (with a good general education) and a supply surplus on the labour market do not incite companies to invest in their employees, as these qualifications can be purchased at any time. Investments in personal qualifications, thus employability, are nevertheless crucial for attaining a dynamic security founded on enhancement of the individual’s capabilities and flexicurity. Without it, in concentrating on plenty of cheap labour, one pursues a strategy that affords no scope for development. This sort of strategy is structurally opposed to the “high road” of development based on qualification and productivity, which is conducive both to competitiveness and to social cohesion, and is therefore the very foundation for reconciliation, according to Katya Vladimirova. In addition, in this context of low income, fiscal limits to official intervention are observed, and this intervention is vital in producing the collective assets represented by training.

Finally, an often limited administrative capability is another obstacle to the implementation of a reconciliation strategy. Eamets describes this limit to the capability of public services and explains how it can mean the inability to use all the funds intended for these purposes, particularly from the European Union. Employment-related institutions and services must be strengthened to be able to contribute more effectively to efforts of reconciliation.

... and paths to pursue

Even if reconciliation is not yet an issue on the political agenda, and considering the present problems of cohesion, a social model also founded on mastery of flexibility nonetheless seems in many countries to be part of the dream of modernity.

Which strategy is the most suitable for reconciling flexibility and social cohesion? The answer that Eamets provides in his article is time and active employment policies. He stresses the important aspect that labour flexibility should be reconciled with social cohesion under a long-term strategy, whereas other fundamental, even existential, preoccupations of citizens and governments loom larger in political debates than problems of flexibility.

The conditions for reconciliation probably need more time to improve. However, since the problems are pinpointed and real enough, there is a consensus among the experts that efforts towards reconciliation should begin today. For many people in these countries, social cohesion is a noble cause but eclipsed by the need for economic development which they consider to be only achievable through a liberal policy of deregulation. However, it is not a viable option to concentrate single-mindedly on economic development and have to deal with its ill-effects at a later point.

Eamets points out that any process of reconciliation and progress towards social cohesion requires trust. Restoring trust among the citizens and making them aspire to their future is an essential task. It is a way of starting the virtuous circle that leads to social cohesion: trust in the other players makes it possible to overcome difficult situations together and bolsters confidence again. This confidence is something to aim for today, especially as institutions are in the midst of transformation. Thus it would be a missed opportunity if one did not use reconstruction to steer the institutional framework onto a course that will allow for more social cohesion tomorrow.

How can this reconciliation be apprehended more definitely?

The articles in this volume map out some interesting paths. As we have seen, given the considerable degree of flexibility, the issue to discuss is how to restore security and make flexibility safe. One must think of “security of wings” instead of “security of the shell”, as some economists say, in other words a protected mobility.

The second requirement is a high-powered education system that allows for better learning of trades, creation of specific human capital and the possibility of lifelong qualification and re-qualification.

A crucial consideration for a strategy of reconciliation is its general applicability, namely outreach to the whole population, including everyone who is unprotected today on the illegal labour market. Better application of the rules of play should be targeted. To achieve this, it is indispensable to

take account of the need for flexibility, as shown today in the blatantly obvious evasion of the rules. In addition, the gap between the written and practised forms of regulations and rights must be closed. This includes the “unrealistic” rigidities dating back to the era of the command economies. Inevitably, the standards of the European Union must be approximated.

Still further steps will certainly have to be taken in a context of a very extensive informal economy, as Sanja Crnković-Pozaić points out. “Protected” flexibility and administrative facilitation should provide means of combating these illicit activities, which are fraught with extreme inequalities and threaten poverty and exclusion. She argues that only a degree of relaxation of the rules, making these non-official dealings superfluous, can enable the entire population to enjoy the right to work. This right must then be enforced energetically. As Ercan and Tansel emphasise in their contribution, progress can slowly and gradually be made towards the enhancement of workers’ rights through a process of legalisation which breaks with a “culture of illegality”. Conversely, in this rationale the state can and must come to the aid of employees with support in addition to the protection of labour.

For a successful strategy, an efficient state is indispensable. But, more than the traditional welfare state, it takes a welfare-oriented society in which all players contribute to the solution. Only a strategy of co-responsibility is conducive to creating this environment of trust, identified as essential. To establish a culture of partnership and mutual understanding, new areas of dialogue are indispensable.

In conclusion, the thoughts collected in this volume reflect the state of the discussions on these questions in the countries of central and eastern Europe. Through the compilation of these texts, the Council of Europe wishes to stimulate a debate on how to deal with the differences between the various realities. Only by acknowledging them can we build a shared future.

Gilda Farrell and Sebastian Sperber

*Social Cohesion Development Division
Council of Europe*

PART I – A PAN-EUROPEAN PERSPECTIVE

I – Reconciling labour flexibility with social cohesion: reflections on eastern and western perspectives in the new Europe

Sabine Urban, Professor Emeritus of Business Administration, University of Strasbourg

Introduction: the problem of maintaining consistency in a complex situation

The concepts of social cohesion (as a desirable policy objective)¹ and labour flexibility (as an aid to more efficient economic policy) were fundamental to the discussions which took place during the forum organised by the Council of Europe in November 2005.

The subject matter of this forum was consistent with the general aim of those who spearheaded the creation of the Council of Europe, when they met as the ICMEU (the International Committee of the Movement for European Unity). Their congress at The Hague in 1949 was presided over by Sir Winston Churchill, who may be regarded as the Council's "founding father". In accordance with Article 1 of the resulting Treaty of London (dated 5 May 1949) enacting the Statute of the Council of Europe, member states shall undertake to "... achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage [including individual freedom, the rule of law and the upholding of human rights] and facilitating their economic and social progress."

Right from the start the Organisation has thus had a political remit to uphold fundamental values and rights. This declared objective, particularly rooted in the context of the immediate post-war period, reflects the desire to encourage Europeans to subscribe to a shared ideal of peace and

1. See Council of Europe, CDCS, *Revised strategy for social cohesion*, Strasbourg, 2004; also *Concerted development of social cohesion indicators – Methodological guide*, Council of Europe Publishing, Strasbourg, 2005.

co-operation. Half a century later, against the background of the fall of the Berlin Wall and the collapse of the communist regimes of eastern Europe, this objective is as valid as ever. The aim is to strengthen the democratic organisation of European society (understood broadly to mean the 46 member states of the Council of Europe) and safeguard the fundamental rights and values which derive from respect for human dignity.² "Social cohesion", by which is meant society's ability to ensure the well-being of all its members, minimise inequalities and avoid polarisation, has become a priority for the Council of Europe and is recognised by all its members as an ideal to work towards. This priority is consistent with a culture of human development broadly rooted in the European cultural tradition, from antiquity to the present day.³

Even so, given the socioeconomic and political events of recent times, which have been different in western Europe and in eastern Europe (formerly under Soviet domination), current situations, and current views, may vary. And it is likely that this tendency will persist, in some areas at least, in both the East and the West, where there continue to be numerous divisions. Subsets are not homogeneous either. This difference in situations or points of view is not inherently a problem, as Europe has a wide diversity of cultures, behaviours and social systems. But one question which arises is that of the right tools for managing this diversity in an environment of "closer unity" and multiple socioeconomic imperatives. In particular, can labour market flexibility be regarded as an appropriate and shared tool for managing the process of adapting to the world around us which is "globalised" and largely unregulated? Can economic and financial interests, which underlie the currently predominant process of controlling change and "modernising" society, be combined with an ethic of "human" development? And does the search for social justice, in the context of globalisation, ultimately impede economic efficacy? The answer to this, from Jean-Paul Fitoussi and others, is a resounding "no". Basing himself on the fact that the most ethically responsible societies are not at all the least productive ones, he contends that it is not the openness of countries to international trade that needs to be challenged, but the rhetoric that seeks

2. This mission is defined in the European Convention on Human Rights (amended from the initial text of 1950) and in the European Social Charter (revised in 1996).

3. See, for example, de Foucauld, J.-B., (2002) *Les 3 cultures du développement humain: Résistance, Régulation, Utopie*, Odile Jacob, Paris; Sen, A. (1989) *On ethics and economics*, Blackwell Publishers; Le Goff, A. (1972) *Un autre Moyen-Age*, Gallimard, Paris; and Lepenies, W. (1985) *Die drei Kulturen*, Hanser, Munich.

to legitimise an excessively dominant and liberal capitalism which takes the view that democracy and politics are obstacles to development.⁴ Unrestrained application of the principle of labour market flexibility, whereby people as the workforce are harnessed in the service of financial productivity, is central to this debate on how to humanise contemporary capitalism, with due regard to the social ties which give society its meaning.

It is well known that in the field of the social sciences the sense of many concepts is fluid, particularly when analysed in an international and comparative context, and this prompts differing interpretations or misunderstandings which may have unfortunate consequences. This generally accepted observation also applies to the ongoing process of integration within the European Union, following the admission of 10 new members (for the most part countries of central and eastern Europe) in May 2004. This “new” Europe is not homogeneous, and happily so, given that in a democracy we attach importance to respecting diversity and the view that this same diversity is an asset to the whole socioeconomic system under consideration, provided it is integrated into the system as a value, recognised by the institutional frame of reference.⁵ The point is made by Milan Kundera who says that cultural diversity is “the” great European value.⁶ Our various experiences constitute an inexhaustible well of inspiration⁷ and one which Europe manifestly needs to draw on.

Flexibility, of labour and the labour market, which is somewhat akin to the concept of freedom, is admittedly not a fundamental democratic value, it tends at present to be imposed as a dominant paradigm of the modern capitalist system’s socioeconomic efficacy, characterised by “extreme competition”⁸ that knows no frontiers and develops at a pace that is likewise extreme. In this case, flexibility would be essential as a means of managing the global socioeconomic system.

4. Fitoussi, J.-P. (2004) *La démocratie et le marché*, Grasset, Paris.

5. See Prodi, R. (2002) “Globalization and cultural diversity: the contribution of European institutions”, in Ricciardelli, M. and Urban, S. (eds.) *Globalization and multicultural societies: some views from Europe*, University of Notre Dame Press, Notre Dame, IN, pp. 137-46.

6. Kundera, M. (2005) *Le rideau*, Gallimard, p. 45 (to be published in English by Harper-Collins in February 2007 as *The Curtain*).

7. *Ibid.*, p. 46.

8. Idea developed by McKinsey (www.mckinseyquarterly.com, October 2005).

This view was discussed and debated at the forum,⁹ having been expressed in considerable preparatory work. It is not for us to go over that ground here, but it may be useful to offer a number of reflections which demonstrate and help us to appreciate that the perceived sense of words (particularly in this case the term labour flexibility in relation to social cohesion) and their interpretation can lead to differences of attitude and behaviour in the various countries concerned. These differences are linked, as we shall show, to history (section 2), to the role of institutions (section 3) and to the results produced by the model applied (section 4).

1. History as a distorting prism

Socioeconomic reality is readily accepted as a construct rather than a pre-determined given. It is clear, therefore, that people's view of history is subjective and coloured by their own experience. This is especially true of the extremely turbulent history of Europe, which has never had precisely drawn and stable borders (what the German political writer Hanns-Albert Steger calls *festgelegte Grenzen*)¹⁰ but rather what the same author refers to as "shifting horizons" (*eine Horizontgemeinschaft*).

Europe, in the face of globalisation, is without a political and/or historical programme.¹¹ As early as 1990, to take just one text, Jacques Delors, the then President of the Commission of the European Communities, was reflecting on how to revitalise the building of Europe and how best to apply the method inherited from Jean Monnet when he said that, confronted with a fast-moving world, "Europe has to move faster. The necessary consensus on this has not yet been reached... There are in my opinion three factors here: the need to define the essential common interests of member states in the world arena, the level of ambition of Europeans and the principle of a common foreign, and also security policy".¹²

The east Europeans, who may or may not be members of the European Union but who are full members of the Council of Europe, are rediscovering

9. Some of the papers are published in the Trends in social cohesion series, Nos. 12, 14 and 15, Council of Europe Publishing, 2004 and 2005.

10. Steger, H. and Morell, R. (1987) *Ein Gespenst geht um...: Mitteleuropa*, Eberhard Vg., Munich, pp. 15-16.

11. See Papayannakis, M., in Ricciardelli, M. and Urban, S., op. cit., pp. 209-16.

12. *Les futurs de l'Europe*, Editions Le Monde and Fondation Europe et Société, 1990, p. 6.

a cultural world of which they are part. The west Europeans (who joined in the first, second or third round of EU enlargement) doubtless do not have exactly the same expectations, perceptions or attitudes. However, all of them today face a very liberal policy of “means of action”, symbolised by flexible and mobile production factors, and the reality of competitive markets. The political ideas (derived from classical theory) voiced in both these areas are close to those heard at the beginning of the industrial age (the late 18th century which saw the invention and use of the steam engine), but the context in which they are applied is very different in the East and the West today, in the age of globalisation, the information revolution and interdependent mass effects.

Between these two eras western Europe, at the end of the 19th century, invented a social dimension for capitalism, in the form of the “social market economy” (in Germany, a multitude of proposals were put forward by the Verein für Sozialpolitik founded in 1873 by Lujo Brentano), and then in the 20th century, after the Second World War, in the form of a societal system which gave prominence to the “welfare state”. At the same time eastern Europe was governed by a collectivist social system, in a command economy, which offered the same degree of social protection for all but allowed for very little mobility (in other words allowed very little flexibility and freedom).

These long and varied periods of social history obviously left their mark.¹³ They could not be erased from the public memory within a period as short as the fifteen years which separate the fall of the Berlin Wall from the present day.

In the Europe of 25, it is hardly likely that “flexibility” and “social cohesion” can mean the same thing straight away, simply because of the fall of the Berlin Wall. The historical baggage of East and West is different. The regulatory forces of freedom and constraint, solidarity and individualism, market economy or command economy have “built” a different societal reality in the two cases. These concepts also lead people to make differentiated value judgments, prompted either by approval or dislike.

History as a succession of events clearly accounts for these differing perceptions, all of them in principle perfectly respectable if sometimes

13. See Tiraspol'sky, A. and Wild, G. (1992) *Economies de l'Est en transition: critères de comparaison*, Travaux et recherches de l'Ifri (French Institute of International Relations), Masson, pp. 13-36.

exaggerated and presented in rigidly black and white terms, which view the Soviet-dominated regime as entirely “bad” and the western system of democracy as entirely “good”. But undoubtedly the greatest impediment to integration and mutual understanding is each side’s ignorance of the other’s culture, because history can also erect and sustain cultural barriers. This ignorance undoubtedly perpetuates misunderstandings. By way of example, let us look at what Milan Kundera says very explicitly when introducing his “Man from the East”:¹⁴

“In the 1970s I left my country [Czechoslovakia] for France where I discovered, to my surprise, that I was ‘an east European exile’. To the French, my country was part of the European East. I was constantly at pains to explain the absolute disgrace of our position: robbed of national sovereignty, we had been annexed not only by another country but by another ‘world’, the world of [Slavic] Eastern Europe which had its roots in ancient Byzantium and thus its own historical baggage... Those I came into contact with saw us as having been ‘communised’, not ‘annexed’... [And yet] the history of the Czechs, like that of the Poles, Slovaks, Croats or Slovenes (and of course the Hungarians who are not Slavs at all) is entirely western – gothic, Renaissance, baroque, close links with the Germanic world, struggle of Catholicism against the Reformation. Nothing to do with Russia, which was a far-off country and a different world. Only the Poles had close ties with their immediate Russian neighbour, though it was more like being locked in mortal combat.”

In cultural terms, the new EU member states have for most of their past been part of the West, and that will certainly make for a convergence of views on many issues. Nevertheless, recent history has forced a different form of diversity upon them, and their experience may be invaluable at a time when virtually all the peoples of the EU are expressing their confusion in one way or another, oscillating between an overt need for protection and solidarity on the one hand and, on the other, for personal freedom, initiatives and unconstrained commitments, in openness towards the rest of the world.

The peoples of the East can contribute more than just nuances of interpretation to the socioeconomic life of the EU, by which I mean more fundamental ideas for future policy. In eastern Europe (and not just those countries which have recently joined the EU) we are in fact witnessing “the restoration of a capitalist society with all its cruelties and stupidities,

14. Kundera, M., op. cit., pp. 58-59 (cf. Footnote 6).

with the vulgarity of villains and *parvenus*. Ideological folly has given way to commercial folly".¹⁵

So it may be that a whole new body of economic and political experience will work to bring about change in favour of "capitalism with a more human face" for the whole of the EU. Flexibility is necessary, and in many respects desirable, but it must be directed in such a way that it is made acceptable to all, in other words cohesive and not socially exclusive.

We should also bear in mind that the "eastern" member states of the EU have good reason not to be wholeheartedly enthusiastic about everything that "western" Europe offers them. Geographically squeezed between the great powers in the west (Germany, Austria and her empire) and the east (Russia and her empire), these countries have seen their borders perpetually shifting, their allegiance regularly challenged by countries that were quick to abandon them, treating them at best with indifference and at worst with violence. "These nations have never been masters of their own fate or of their own borders. They have rarely shaped history, but have almost always been on the receiving end of it."¹⁶ Thanks to their membership of the EU they now have the chance to play their full part in shaping history, to engender and put forward ideas and proposals. The new members have made their mark on recent European and world history with a long period of anti-Soviet revolt, in Poland, Hungary and Czechoslovakia. "To me there is nothing more admirable in the Europe of the second half of the 20th century than this golden chain of revolt which for forty years undermined the Empire of the East, rendered it ungovernable and ultimately sounded its death knell."¹⁷

These bursts of resistance, born of a belief in and hope of freedom and social cohesion, reflect the political visions of the Council of Europe and its commitment to human rights and democracy.¹⁸ The battles for democracy which have been fought and won also suggest that the traditions of the East and the West might easily be combined: the established laws and conventions of the West and the contributions from the East to democratic and major societal change.

15. Ibid., p. 40.

16. Ibid., p. 61.

17. Ibid., p. 63.

18. Council of Europe, (2005) *Concerted development of social cohesion indicators – Methodological guide*, Council of Europe Publishing, Strasbourg.

This thought also underlines the urgent need for a true European political project, broader than the vague idea of globally competitive but essentially mercantile capitalism which rather forgets the famous statement of Jean Bodin, a 16th-century French philosopher and economist, that “mankind is the only true source of wealth”. A project should be much more than a system for regulating and allocating resources by market forces (which can, if necessary, be corrected by government).

For the moment there are powerful “fields of force”¹⁹ in Europe, but Europe is in a position of asymmetrical power which disadvantages it vis-à-vis the main world growth poles organised for and by dominant or emerging nations (USA, Japan, China, India).²⁰ Only an attractive political project can make up for the relative handicaps which Europe suffers from today – poor organisation, limited international bargaining power, an ageing population, brain drain, inadequate R&D and innovation, limited defence and security capacity, no obvious vision, etc. Collective action is unthinkable and cannot be feasible without reference to the project and its underlying aspirations. And present-day Europe lacks commitment, lacks the persuasiveness which could create a knowledge-based dynamic and breathe life into political relationships. In both East and West, a twofold dynamism of this kind, following clear and proactive lines, could have an extraordinarily positive effect, for Europe and for other parts of the world. It would mean moving beyond a model of shareholder value creation to one of co-operative value creation which benefits human beings.²¹

The lack of any political project on a supranational scale has meant that social responsibility has been transferred in moral terms to the business world (the idea of “corporate social responsibility”), but this trend is still in its infancy, especially in large companies, since small businesses are far more aware and proactive when it comes to social and societal responsibility. A public-private partnership is taking shape, little by little, but at the same time “irresponsible” corporate behaviour is discernible on a large scale,²² and this casts a shadow across the overall picture. So we cannot go on much longer dodging the issue of governance, or rather systems

19. Expression borrowed from F. Perroux.

20. For a theory of power, see Perroux, F. (1973) *Pouvoir et économie*, Bordas, Paris.

21. See Bartoli, H. (2005) “François Perroux, Précurseur de l’alter-mondialisme”, in Barre, R. et al. (2005) *François Perroux, Le centenaire d’un grand économiste*, Economica, Paris, pp. 13-33.

22. See Gallino, L. (2005) *L’impresa irresponsabile*, Einaudi, Turin.

of (macro- and micro-) governance, without risking irreparable damage to society.

“The eastern enlargement is now reality, and new governance solutions must be thought and implemented to the advantage of Easterners and Westerners alike: it is not yet time for Europe to give up its lead in institutional innovation.”²³

2. The role of institutions

The introduction of a highly privatised market economy has ushered in a period of delicate transition in the East, with winners (generally younger people, more amenable to rapid “modernisation” of the system) and losers (generally older people who find themselves robbed of decent social security or pensions). In the West the policy of “modernisation” has led to painful processes of adjustment through more rigorous application of a principle of labour market flexibility (accompanied by greater precariousness) and the relocation of industrial and service enterprises (resulting in more unemployment). Situations of this kind cause attention to be focused more on the role of institutions.

Today, that role has been highlighted by a recent winner of the Nobel Prize for Economics (1993), Douglass C. North, who may be described as one of the chief spokesmen for the school of “the new institutional economics”.²⁴ North says that classic economic thinking is concerned essentially with resource allocation; but when we look at the process of economic change in a global and complex context, we have to broaden the field of observation. To do this we have to understand the role of institutions in the structure of human interaction (necessary if we are to understand the dynamics of socioeconomic change).

According to North, economic growth requires the development of increasingly sophisticated institutions and the establishment of effective co-operation structures. Institutions and the technology employed

23. Manzocchi, S. (ed.) (2003) *The economics of enlargement*, Palgrave Macmillan, p. 11.

24. See, for example, North, D.C. (1990) *Institutions, institutional change and economic performance*, Cambridge University Press, Cambridge, MA; (2005) *Understanding the process of economic change*, Princeton University Press, Princeton, NJ; and “Institutions and the process of economic change” in *Management international/International Management/Gestion Internacional*, Vol. 9, No. 3, spring 2005, pp. 1-7.

determine socioeconomic performance. North defines institutions as formal constraints (rules, laws, constitutions) and informal constraints (norms of behaviour, conventions and self-imposed codes of conduct), together with their enforcement characteristics. If institutions are the rules of the socioeconomic game, organisations are the players. They are made up of groups of individuals bound together by some common purpose: firms, trade unions, associations, political parties, etc. Institutions and organisations interact with each other, under the influence of their common cultural heritage, but at the same time, according to North, there is nothing which automatically guarantees their socioeconomic efficacy in the context of a market economy. For that, good political governance is needed. This comes not from a universal “top down” design, but from negotiation and dialogue, as well as from path dependence.

We may deduce from this that western and eastern Europeans (two substantially different subsets) have to construct their common model for institutional change using a dedicated approach comprising three components: (1) the “reality” of a socioeconomic system built chiefly on demographic features, the knowledge base and the institutional framework; (2) the perception of reality, namely the prevailing value systems and (3) the rules and decision-making apparatus put in place by the players.²⁵ The building of a new architecture of this kind requires the implementation of a shared system of learning which benefits both from past experience and from a range of models for interpreting reality, in order ultimately to carry out a joint project.

The work of construction is not easy, not only because openness to negotiation and dialogue is something that does not come naturally to everyone, but also because available data on past or ongoing experience, and their validity in terms of the performance levels sought, are very imperfect and partial. This methodological pitfall, which detracts from the objective quality of negotiation, is highlighted in a 2003 report of the ILO (International Labour Organization), by Sandrine Cazes and Alena Nesperova, on the subject of “labour markets in transition; balancing flexibility and security”.²⁶

By way of illustration we can point to the fact that information on the substance of true collective bargaining (in the East) is inconclusive, since it covers essentially the aspects of pay and employment conditions of persons

25. See North, D.C., in the review *International Management*, op. cit., pp. 4-6.

26. Cazes, S. and Nesperova, A. (2003) *Labour markets in transition: balancing flexibility & security in central and eastern Europe*, ILO (International Labour Organization), Geneva, pp. 123-43.

actually in work, ignoring the problems of persons who are seeking work. Little is known of the role of trade unions, and this remains ambiguous. On the other hand, statistical tests show that the impact of tax treatment on employment is significant, though it is not having the same effects as the labour market programmes (for young people in particular) that have been analysed. Many factors are acknowledged to influence recruitment and employment, but there is a dearth of multivariate analysis. Data on labour supply are not homogeneous in the countries of the East and the West, and the same is true of demand. It is also apparent that pro-cyclical and anti-cyclical policies are not the same in the East and the West. These practices, which are determined by employers, not workers (who are in a disadvantageous position of asymmetry), thus have a different impact on perceptions of job insecurity. In short, according to the ILO, indicators of labour flexibility and the labour markets have to be handled with extreme caution – they are “far from perfect”. And there is currently no clear answer to the equally important question of how labour legislation affects the overall employment rate. This is unlikely to facilitate efficient dialogue between employers (who want a high degree of labour market flexibility) and workers (who want a high level of job security).

However, in the light of numerous studies based on (incomplete) empirical assessments, the ILO report highlights a number of “policy conclusions” which it deems relevant²⁷ and which we reproduce here.

By way of a general observation the authors begin by stressing that the countries of the East, in their transition towards a western-style market economy, have undergone profound changes in the management of labour, but the outcomes have been to a large extent different from expectations. Their conclusions can be summarised under 10 headings:

- a. The rate of employment (artificially raised to near-full employment under communism) remains broadly unsatisfactory: unemployment remains high.
- b. In those countries which have made the most progress here, employment is becoming structured by sector of activity along the same lines as in the West: farming and industry account for a declining share of total employment, whilst the share of services is increasing.

27. *Ibid.*, pp. 137-43.

- c. Contrary to expectations, the number of employers and the self-employed performing own-account activities has risen only slightly and does not contribute significantly to total employment.
- d. “Flexible forms of employment” are on the increase: these encompass paid activity in the form of holding multiple jobs, or a primary activity combined with second, formal or informal jobs, official unemployed status which simply means a lack of formal employment, and frequent insecure employment under one-off private arrangements which are not covered by the labour laws.
- e. Labour market flexibility, measured by the speed of labour turnover, is high, intensified by cuts in the number of steady jobs available.
- f. The principles of employment protection legislation (EPL) are becoming more closely aligned between East and West, but there are very significant differences from one country to another.
- g. EPL does not seem to have had a major impact on the employment rate but it has significantly resulted in a lower labour turnover. The ultimate result of this is a marked segmentation of the labour market into insiders and outsiders, the former enjoying greater job stability whilst the latter are in a more insecure employment situation.
- h. After the end of communist rule the eastern countries adopted institutions and policies for regulating employment which compare with those of the West, namely: collective bargaining arrangements, labour taxation, unemployment benefits, labour market policies, etc. But these similar arrangements have been applied in the East in a manner very different from in the West. Trade union membership may be higher in the East, but unions there have less influence, largely due to the fragmentation of trade union operations. Taxation (as a percentage of wage deductions) is very high in the transition countries. By contrast, however, the level of unemployment benefits and the proportion of gross domestic product (GDP) expended on labour market policies are generally low.

(This doubtless goes some way towards explaining the East-West differences in the labour force’s behaviour and perceptions of the market, flexibility, insecurity, illegal working, etc.)
- i. The impact of employment protection policies seems to be different: it tends to be negative in the West and positive in the East.

- j. All the labour market indicators analysed by the ILO (labour market participation, unemployment, youth unemployment, long-term unemployment) are positively affected by collective bargaining and active labour market policies.

This ILO study points to the difficulties of applying a new social model in Europe. Dialogue between employers and workers is important but it is not enough; there must also be dialogue between the legislature and social partners, and government must be especially vigilant to ensure that rights are upheld. Otherwise the result is a poor utilisation of human capital. The report also underlines the importance of (macroeconomic and microeconomic) growth which will encourage the creation of good-quality jobs and ultimately replace old, low-productivity jobs.

Fostering growth and promoting employment through the quality of labour as well as of material and non-material infrastructures are also of relevance to the West. Policies aimed at social dialogue (going beyond the Marxist class struggle) and at stimulating global demand (through a Keynesian policy) are these days proving less and less able to resolve the problems posed by a globalised economy and financing system: there are too many leaks in the economic circuit. The shrinking borders of the “global village” allow many things to move freely from one area to another – purchasing power, decision-making power, money from drugs, fraud and corruption, physical disease and moral sickness. We need to rethink the levers of action.

3. The search for an effective model

Certainly, and almost by definition, it is hard for anyone – politician, economist or simply the man in the street – to understand a complex and chaotic situation of the kind we are experiencing at present. Hesitation born of uncertainty is reflected in the election results of recent years, in both East and West. Increasingly, abstention, reflecting a loss of democratic vigour, is almost everywhere. Parties of a nationalistic colour, which are wary of opening up to others and to the world at large (including neighbouring areas), are gaining ground. People are frightened of the unknown and the unfamiliar and are increasingly taking refuge in their own sense of identity. Voters in the East, or at least some of them, seem to be thrown off-balance by the post-communist transition. In the West, economic “revolutions” (due to globalisation), or scientific and technological revolutions in information, genetics or other areas, are lending a sometimes terrifying aspect to the unknown territory of the future (which is no longer properly “mapped” in a coherent manner). This is to some extent true in the East too.

Both East and West are searching for points of reference, for a model. Western Europeans, and on a more global level the USA, tend to think that their model is best and that it must be imposed, by persuasion or force. This is somewhat naive or arrogant and, in the case of Europe which is our concern here, this belief is not altogether justified. What exactly does “upholding the European social model” mean?²⁸ How can we judge the efficacy of the social market economy and the European Union’s performance in terms of the Lisbon Strategy (of March 2000) which envisages sustainable development in all its forms – economic, social, intellectual, environmental – but has no operational timetable based on a declared amount of available funding? How can the operation of a 25-member EU be made to appear credible without an appropriate policy and management framework? Its incantatory utterances are not grounded in any solid foundation, and the facts and figures tell a consistently different story.²⁹

According to media sources, flexibility is the means to full employment,³⁰ liberalism is the loyal friend of employment, flexibility is a precondition for growth (and thus a potential pillar of a generous welfare state, as shown by the Scandinavian countries), whereas the French themselves describe their social model as having “run out of steam”.³¹ “France and its social system can no longer export anything but their failures.”³² Germany, for its part, is wavering between liberalism (based on the principle of individual financial responsibility) and social justice (based on the principle of solidarity) and is seeking a compromise here in the difficult context of a “grand coalition”. In short, confusion reigns in hearts and minds and on the ground, with one factor that makes the situation worse for the whole of the newly enlarged Europe: an ageing population, which pushes up the cost of health care and pensions.

28. See Urban, S. (2005) “The European welfare state under pressure: between European and global integration. Some critical issues”, *The European Union Review*, Vol. 10, No. 2, pp. 7-43.

29. See European Commission, “The broad economic policy guidelines (for the 2005-08 period)”, *European Economy*, No. 4/2005; “The EU economy 2004 review”, *European Economy*, No. 6/2004; and “EMU after five years”, *European Economy*, Special Report No. 1/2004.

30. *Les Echos*, 22 June 2005.

31. *Le Monde*, 3 June 2005.

32. *Le Monde*, 30 May 2005.

Hasty claims in either direction are no doubt exaggerated, because in many respects Europe can be proud of its welfare states, but equally it is beyond doubt that a critical review of them is overdue. Self-criticism of a system should not be seen as a sign of weakness but rather as proof of confidence that the system in question can be reformed in a sensible, reasoned and consensual manner.

Exclusion from the labour market of persons of working age is clearly something of particular concern to European societies. It damages social cohesion and is therefore a threat to peace. Europe is hit harder by this situation than other developed regions (Canada, USA, Japan) and labour market flexibility is not really the answer.

In a rapidly changing world, the very principle of the need for flexibility cannot be rejected; logic requires it, but it must be properly defined. The various experiences in Europe provide food for thought on the accompanying measures that are needed.

These accompanying measures also vary depending on the type of labour market flexibility preferred. The European Commission defines the following types (which may be considered in any combination appropriate to the circumstances, with no one model being singled out as the optimum solution for the whole of the EU):³³

- a. overall wage flexibility, difficult to apply, requiring amongst other things close co-operation and a convergence of views amongst the social partners, plus a high degree of co-ordination amongst the EU member states;
- b. relative wage flexibility, introducing wage differentiation according to productivity and local market conditions; this system produces sectoral and geographic co-ordination through wage bargaining, which may also set minimum wages;
- c. flexibility based on the free geographical movement of labour within the EU;
- d. occupational mobility, with the workforce being willing and able to change jobs;

33. See report "EMU after five years", 2004, op. cit., pp. 160-7.

- e. flexibility reflected in the willingness of the potential workforce (unemployed and inactive individuals) to seek employment and adapt to the requirements of jobs proposed; this attitude can be encouraged by a system of social benefits;
- f. numerical flexibility prompted by a need to adjust overall staffing levels to conditions on the markets where employers sell their products and procure their goods and services; this kind of flexibility typically entails temporary contracts, insecure employment, partial and temporary unemployment;
- g. functional flexibility, reflecting a willingness to tailor work organisation to suit preferences, made possible by training and potentially opening the way for part-time employment;
- h. firms' entry to or exit from the market involving the creation, elimination or relocation of jobs.

These categories suggested by the European Commission are of course not the only possibility; they are informed by a predominantly macroeconomic line of thinking, but they have little basis in real managerial practices (which have repercussions on workers' living conditions, in addition to effects on markets and business competitiveness and profitability).

Luciano Gallino's analysis³⁴ gives a further insight into business practice here. Gallino makes a distinction between flexible employment (with different kinds of work contracts), flexible hours (which vary at different periods of time) and flexible productivity (with varying performance requirements for varying times), these three types of flexibility not being mutually exclusive. In most businesses operating in a fiercely competitive market, performance and productivity requirements have been stepped up considerably in recent years, to the detriment of workers' health and well-being. The production system uses up the human resource to a point beyond what is reasonable and destroys it (by premature ageing of workers, stress, anxiety, etc.; this necessitates periods of time off work, medical treatment or early retirement, which are expensive for the employer and wasteful of resources and skills).

When measuring the phenomenon of flexibility (now used as a system of management in both the East and West), account must also be taken of the impact of organisational change. The trend in businesses

34. Gallino, L. (2005) *L'impresa irresponsabile*, Einaudi, Turin.

(and particularly large groups listed on the stock exchange) is to break down their value creation chains: their operations and assets (tangible and intangible) are now spread over socioeconomic areas which are especially attractive in profit terms. This is a game of shifting goalposts, where rules and backgrounds are quick to change. It reduces the bargaining power of trade unions, and jobs are created and disappear as decisions are taken to outsource supplies, operations and services or move them offshore. Working conditions thus become increasingly unstable, uncertain, non-negotiated and presented as inevitable. Not only labour, but the whole of the production system is being “flexibilised”, with the systemic risk that this entails. That high risk is evidenced by the fact that almost half of all acquisitions and mergers worldwide fail (in terms of overall socioeconomic performance).

These various forms of flexibility are broadly practised by Europe’s main economic competitors, in America and in Asia. A Europe seeking to be competitive cannot afford not to be flexible, but it must define the priorities it intends to promote, along with the accompanying measures necessary: taxation policy, legal safeguards and proper regard for employment rights,³⁵ social protection, shared funding of the costs of implementation during a transitional period, etc. These could be the defining measures for a true “European social model” based on social cohesion. In the absence of any such debate, with statements of political intent followed up by real action, the vacuum is likely to be filled by partial measures born of fanatical behaviour along religious fundamentalist lines, with damaging effects which we can either see already or can readily imagine. Europe has introduced the principle of the separation of church and state in many of its member states; this should prompt Europe to seek solidarity on a mainly secular basis, with people left entirely free to practise faith-based solidarity if they wish. Wolf Lepenies summarised this imperative in his speech accepting the Peace Prize of the German Book Fair in Frankfurt on 8 October 2006, in which he expressed his desire to see a democracy which respected religious freedom and the freedom to have no religious faith (*Religionsfreiheit und Freiheit von der Religion*).

35. See Moreau, M.A., at the Council of Europe forum held on 17 and 18 November 2005.

4. Conclusion

By way of a conclusion let us draw on sociology. Individuals as well as groups, citizens as well as officialdom, need to be motivated either by aspirations, shared endeavours, or rational undertakings based on observable outcomes and performances. Europe at present faces this twofold challenge, the need to stimulate and the need to be credible, to mobilise all creative minds and allow innovative leadership to emerge.

Europe and most particularly the Council of Europe are associated with the upholding of democratic and liberal values and respect for human rights and the rule of law. Balancing free market liberalism (which may mean that use of mechanisms such as labour market flexibility is abusive in certain circumstances) against respect for ethical principles (such as respect for the dignity of human beings in the exercise of their economic activity) can be a delicate matter, but it determines the viability of a democratic power. A thriving democracy cannot be imposed solely from the outside or from the top down; it must be rooted in the living forces of the social system from the bottom up and thus be supported by social cohesion.

Europe is not totally “united”; it remains “multiple”. These two characteristics may be seen as opposite poles which can help it to progress. Europe is a kind of “work in progress” with an open completion date – it has to keep moving. Its place, in view of its history, is not to lay down the law but to expound ideas, drawing on the experience of both East and West.

II – Labour flexibility and social cohesion in central Europe: a historical perspective

*Jacek Kochanowicz, Professor of Economic History,
Warsaw University and the Central European University, Budapest*

Introduction

Has the collapse of state socialism led to a flexibilisation of the labour market in central Europe? If so, has such flexibilisation led to a deterioration of social cohesion? While the answer to the first question is obvious, it is far from easy to respond to the second one. The flexibilisation of labour markets – a process characteristic of the recent phase of development of capitalism, and transferred to central Europe after the fall of communism – is only a part of a much broader change affecting social stability in this region. In other words, if there are signs of the weakening of social bonds in central Europe, it is by no means sure that the flexibilisation of the labour market is the only or even the main cause. Thus, the changes in labour relations have to be analysed as one of many parallel and inter-related social processes, connected to the post-communist transformation.

The concept of social cohesion, so widely referred to in western Europe, is rarely used in central Europe, and then mostly among specialists. Thus, its relevance to this region requires its historicisation, or an interpretation of the contexts and circumstances from which this idea emerged. As a theoretical concept, “social cohesion,” although intuitively attractive, is not easy to define as such a definition requires a reference to some kind of general theory of society.¹ It presupposes the existence of a social whole, and suggests that for its stability, individuals must have a collective identity as well as feelings of belonging and acceptance. The question arises as to what kind of a whole do we have in mind, and what do we mean by a “society”. Classical sociology introduced several distinctions, the most important being *Gemeinschaft* vs *Gesellschaft*, and “traditional society” vs “modern society”. Much work in sociology has been done precisely on what forces keep the modernising and modern societies together, and what forces tear them apart. While sociologists usually speak about a “society” in abstract terms, in practice, the modern society has most often

1. For a discussion, see *Concerted development of social cohesion indicators – Methodological guide*, Council of Europe Publishing, Strasbourg, 2005, pp. 3-28.

been treated as synonymous with a nation, for instance “British society,” or “Polish society”. In what follows, there shall be only incidental reference to sociological theories. This paper relies instead on a comparative historical analysis, even though it is conducted on a relatively abstract level.

The focus is on central Europe and on the period after the collapse of state socialism. But it is difficult to understand the situation in this region at that particular time without some comparisons, and without taking into account a somewhat longer perspective. The most telling comparison is with western Europe, for at least two reasons. One is that the concept of social cohesion emerged in, and is currently debated with reference to, western Europe. The second, most obvious, is the recent accession of central European countries to the European Union. The longer perspective requires taking into consideration the period of state socialism. For the sake of the present paper, central Europe is understood as comprising the Czech Republic, Hungary, Poland and Slovakia (and most of the illustrations come from Poland).² These countries historically and culturally were close to the West in cultural terms, yet developed clearly distinct economic and social institutions (the closest to the West thus the least “Eastern” was Bohemia, now the main part of the Czech Republic). Thus, during the last millennium these lands obtained Christianity from Rome, developed medieval legal institutions in the German tradition, and were influenced by European high culture. At the same time, the economic and social distinctiveness from the West (less accentuated in the case of Bohemia) consisted of the second serfdom of the peasantry between the 16th and the 19th centuries, weak towns and bourgeoisie, belated industrialisation and modernisation, and – last but not least – the communist experience in the period from 1944-49 to 1989.

This paper is organised into four sections. Section one looks at the idea of social cohesion in the western European context. It serves as a frame of reference for the next three sections which focus on central Europe. Section two analyses social cohesion in central Europe before and under state socialism. Section three looks at the structural changes after the fall of state socialism, and their consequences for labour relations, and section four focuses on the political consequences of these structural changes.

2. There is a long discussion about the possible delimitation of eastern Europe and its regions. See, in particular, Wolff, L. (1994) *Inventing eastern Europe: the map of civilization in the mind of the Enlightenment*, Stanford University Press, Stanford; and Todorova, M. (1997) *Imaging the Balkans*, Oxford University Press, New York.

1. Social cohesion in the western European context

The notion of social cohesion came into use in western Europe at the beginning of the 1980s, precisely at a moment when it became evident that something went wrong with it – when problems such as chronic unemployment, poverty (*nouveaux pauvres*), social exclusion, etc. became clearly visible. These problems revealed the cracks in the body of the so-called European social model. This concept is clearly related to the institutions and ideas of the welfare state, as developed after the Second World War, and was instrumental in achieving social cohesion in western European societies.

The European welfare state – a set of institutions and policies aimed at safeguarding citizens from risks related to the market economy – functioned relatively smoothly until the beginning of the 1970s. Afterwards, western European economies found themselves in stagflation, and started to face fiscal problems, while the welfare state increasingly failed to live up to its promises and as a consequence came to be regarded as more of a problem than a solution. Social scientists began contrasting the European continental model of capitalism with the American, or Anglo-Saxon model, based on less social security and – among other things – on more flexible labour markets.³ The shift of academic economics from neo-Keynesianism towards a supply-side, monetarist, neo-liberal approach, symbolically strengthened by the Nobel prizes for Friedrich Hayek and Milton Friedman, reinforced positions of the critics of the welfare state. While it has not been dismantled anywhere in Europe, almost everywhere the welfare state has been under criticism for the last thirty years, and economists in particular have called for its reduction and reform.⁴ To put the European welfare state in a historical context, it is necessary to reflect on both the reasons for its initial introduction, the conditions and causes of its relative success until the 1970s and its troubles afterwards.

The early origins date to the period of the second industrial revolution (1870-1914), with the massive social changes and dislocation it initiated. But the real great leap forward (easily measurable by a steep increase in the share of social expenditure of the GDP) came after the Second World War. Already during the war the Beveridge Report (1942) laid out plans for universal

3. One of the earliest and most discussed publications is Albert, M. (1991) *Capitalisme contre capitalisme*, Seuil, Paris.

4. Cf. a publication widely discussed at the time: Rosenvallon, P. (1981) *La crise de l'Etat-providence*, Seuil, Paris.

national social protection, while authors like Karl Polanyi argued that no society can rely solely on market co-ordination, as it would destroy the social fabric and, in consequence, would lead to radical anti-market movements.⁵ Thus, the rise of the welfare state after the Second World War – to which various ideologies and political movements from social-democratic to Christian democratic contributed – can be interpreted as an answer to the perils the Europeans found themselves in between 1914 and 1945, such as the decline of democracy and the rise of nationalist, fascist and communist movements.⁶ Democracy, which was the catchword for the new order to be established after the war, was to be sustainable only when “social rights” would be added to “human rights” (equality before the law), as articulated by the Enlightenment, and political rights (universal franchise), as had been gradually introduced since the second half of the 19th century.

Precisely in this sense, the welfare state was an instrument to achieve and to maintain social cohesion. It was an attempt to replace, or rather to improve, the earlier way of making modern societies cohesive – the nationalist idea, developed in the 19th and early 20th centuries. Nationalism in turn had replaced earlier forms of collective identity, related to a locality, an estate of the realm (*Stände*), a religion, a ruling dynasty and the like. Nationalism replaced them by an identity based upon a common culture: language, customs, sets of beliefs, myths and ideologies. In the words of Ernest Gellner, nationalism is an ideology claiming that cultural and political borders should overlap.⁷ Its rise was one of the most important aspects of modernity; it is indeed difficult to imagine the history of much of the modern world without taking this concept into account. Its agents were intellectual elites and the modern state.⁸ Using such means as mass literacy and education, but also the army, they contributed to constructing this new type of collective identity. Nationalism could have different variations, more ethnic or more civic, and could take benign, but also virulent forms. Unfortunately, this was the case in Europe in the first half of the 20th century, and these extreme nationalist ideologies contributed to both world wars.

5. Polanyi, K. (1977 [1944]) *The great transformation: the political and economic origins of our time*, Beacon Press, Boston.

6. Judt, T. (2005) *Postwar: a history of Europe since 1945*, William Heinemann, London, pp. 360-89.

7. Gellner, E. (1983) *Nations and nationalism*, Basil Blackwell, Oxford.

8. See Hobsbawm, E.J. (1990) *Nations and nationalism since 1780: programme, myth, reality*, Cambridge.

The welfare state was an attempt to find a different way of building social cohesion – not rejecting the idea of a nation, but adding a strong dose of democracy, founded on the idea of social rights. Indeed, in each and every case, the welfare state has had strong national characteristics, and to this day the member states of the European Union enjoy a large dose of freedom in the area of social policies. The welfare state had been built on the foundation of social solidarity, the boundaries of which were set, basically, by the national community. In the post-war years, the task was relatively easy in the sense that most of the European countries were less culturally diverse than they are today.

But the lesson of the “Age of catastrophe”, to borrow Eric Hobsbawm’s term, was that social cohesion within a nation is not enough.⁹ Drawing the lesson from the two devastating wars, Europeans were looking for institutions that would safeguard not only intranational, but also international cohesion. The answer was the European idea, a twin sibling of the welfare state. The founding fathers of the united Europe hoped that by establishing common economic institutions they would contribute to the creation of new structures of material interests which would see more advantages in co-operation than in conflict. Miraculously, this idea worked. And, while European integration did not do away with nations, and while it apparently failed to construct a European identity that eclipsed national identities, it definitely made European nations more benign. Additionally, the Cold War strengthened the “Western” (Atlantic) sense of community, as defined against the threat of communism. The real or perceived successes of communism – in the field of social policies as well – gave western governments powerful incentives to look for ways to avoid social conflicts, which could be exploited by the other side.

No doubt, one of the factors explaining the early successes of the welfare state was high economic growth, as its heyday coincided with the three post-war “golden decades”.¹⁰ Moreover, expectations towards its institutions were relatively modest, as people remembered well the penury of the great depression and the war years, while the era of consumerism was only at its beginning. Also, employment was near full and life expectations relatively low, which resulted in limited numbers of people who would

9. Hobsbawm, E.J. (1994) title of Part One of his *The age of extremes: the short twentieth century 1914-1991*, London.

10. Van der Vee, H. (1986) *Prosperity and upheaval: the world economy 1945-1980*, Viking, Harmondsworth, pp. 48-78.

have to be supported either through unemployment benefits, or through retirement schemes and social assistance. Finally, European societies at that time were more homogenous culturally than today, which made appeals to social solidarity (income redistribution by taxation) relatively easy.

In the 1970s, growth stagnated, while at the same time a generation born after the war and with no memories of hardships, but socialised in the culture of consumerism, was coming of age. Expectations as to what the welfare state should provide were now greater, while the possibilities of financing them did not increase in proportion. The ageing of populations increased numbers of non-productive members of society. These problems were aggravated by further developments in European economies and by the wider trends of the world economy that operated in the last quarter of the century. Europe was losing industrial manufacturing to Asia and increasingly changing into a service economy. The traditional working class declined in numbers and lifelong employment became increasingly rare. Unemployment was rising, while labour market arrangements changed towards more frequent part-time and temporary employment. In the service sectors, the labour market became fragmented and hierarchical, with highly specialised, qualified and well-paid “symbolical analysts” on the top, floor scrubbers and the like on the bottom, with a decreasing middle tier.¹¹ In addition, the bottom category of the labour market is increasingly being filled by immigrants, poorly integrated with the host society for cultural and religious as well as economic reasons. Thus, as a result, there is no homogenous “working class” with its inherent solidarity as a political basis for welfare-state policies; in addition, the more prosperous members of society feel little solidarity with the poor and the excluded, particularly when these groups are ethnically different.

Current conditions are different from how they used to be when the welfare state was expanding. The flexibilisation of the labour market, characteristic of the post-industrial economy, is but one factor eroding social cohesion. Mass immigration – also affecting labour relations, but having tremendously important cultural consequences – makes western European societies more fragmented and less stable. The welfare state, as created in the post-war years, is tackling these problems with increasing difficulty. There is constant talk about the necessity of reforms, but also resistance towards such reforms, as we see in France and Germany.

11. The term “symbolic analysts” is of Reich, R.B. (1992) *The work of nations: preparing ourselves for 21st century capitalism*, Vintage Books, New York.

2. Social cohesion in central Europe before and during the communist era

In pre-communist times, social cohesion in central European societies – except for the Czech lands which were predominantly rural – was being built, as was the case in many other places, around the idea of the nation. In the 19th century, these countries did not have their own states (although the Habsburg monarchy granted considerable cultural and some political autonomy to its various peoples, particularly the Hungarians), so the idea of the nation was mostly constructed by the intellectual elite and manifested itself in literary and other artistic forms. Already at that time it often took on an exclusive, ethnic character, as it had to position itself versus various ethnic minorities. This became more serious when, after 1918, the countries of central Europe gained political independence and when a belated, in relation to western Europe, state building became the first priority.

The Second World War and the imposition of state socialism changed the central European societies in a profound and extremely painful way. It is enough to list the extermination of Jews, the forced resettlement of millions of Germans from what is now Poland and from Czechoslovakia, the mass migrations of hundreds of thousands of Poles from the territories annexed by the Soviet Union, and other tens of thousands wandering around because their homes and work places were destroyed, to see to what an extent the social fabric was torn apart. The new, totalitarian regimes, established with the backing of the Red Army, went further, stripping property from members of the former upper and upper-middle classes, brandishing them as class enemies, putting them in prisons and often eliminating them physically. Thus, the former bonds of social cohesion were destroyed and the decks cleared for the realisation of the communist social project.

The most important part of this project was industrialisation. The reasons were ideological as well as practical. Ideologically, industrialisation was supposed to move Soviet and eastern European societies to more advanced stages of “historical progress”, thus developing an industrial working class, the backbone of the socialist society of the future. It was also expected to impress the non-socialist world with the achievements and might of socialism. In more practical terms, it was designed to take these societies out of their backward, agricultural condition and to solve various problems of the day. In summary, it was a project for a new kind of civilization.¹²

12. Kotkin, S. (1995) *Magnetic mountain: Stalinism as a civilization*, University of California Press, Berkeley.

The outcomes of this development project were, in a certain sense, impressive. Within a few decades, the Soviet Union (and later, eastern European countries) became industrialised and the economic gap between the socialist countries and the West seemed to decrease. Only later it became evident that this industrialisation was no more than an imperfect copy of the Western Fordian model. The results were also impressive in terms of the social change triggered by industrialisation. Despite its stress on heavy industries, the result was overall modernisation: urbanisation, increases in the standard of living, increases in the literacy levels as well as improvements in health care and in the access to other social services. In the early 1960s, many socialist countries appeared to be well advanced on the road to modernisation. In much of the Western scholarship of the time, they were regarded just as variations of industrial societies, perhaps on the way to converge with the Western mixed economies in the not so distant future. They also projected an image of internal stability due to a lack of social tensions.

That was the case particularly when the regime gradually softened after Stalin's death. Stalinism attempted to build social cohesion and its own legitimacy along the logic of totalitarian politics, through the recurrent mobilisation campaigns, and through the incessant propagation of its ideology. In the post-Stalinist era, the militant, promethean, anti-imperialistic Marxism was toned down and replaced by a mixture of nationalist and modernising ideologies. In some cases, as in Ceausescu's Romania, it went so far that the regime was dubbed "national communism".¹³ In Poland during the 1970s, the catchword of the propaganda was the "moral and political unity of the nation," a concept much closer to pre-war nationalism than to Marxism. But by far the most important institution for achieving social unity and cohesion was what may be called the socialist welfare state.¹⁴ The three pillars of the socialist welfare state were full employment, price controls combined with rationing and universal accessibility of services such as education and health care, as well as pensions, sickness pay, childcare benefits, maternity leaves, etc.

Full employment, or the right to a job provided by the state, gave most people the means to live. Prices and wages were set by the administration,

13. Verdery, K. (1991) *National ideology under socialism: identity and cultural politics in Ceausescu's Romania*, University of California Press, Berkeley.

14. Berend, I.T. (1996) *Central and eastern Europe 1944-1993: detour from the periphery to the periphery*, Cambridge University Press, Cambridge, pp. 165-69; and Narojek, W. (1991) *Socjalistyczne "Welfare state"* (The socialist "welfare state"), PWN, Warsaw.

and basic commodities (food, but also housing) were subsidised. Rationing, in open or disguised forms, allowed access to basic, but scarce commodities. Finally, pensions, education and health care, but also various kinds of more specific benefits, were provided by a centralised, bureaucratic state machinery. Social protection was standardised and its distribution was centralised; social insurance was integrated into the state budget and medical care was provided by a universal health care service and separated from social insurance.¹⁵

The workplace played a very special role in this system. It served as much as a production unit as one of social control, and also as a channel of access to scarce goods and services, particularly in the case of the larger and more important businesses. They had their own health clinics, resort homes, housing programmes, and often distributed such highly prized consumer durable goods as cars or colour TV sets. This system grew in importance through time, as – once full employment had been achieved – companies competed for skilled labour by offering not only pay, but also scarce goods and services. As employment in a given place was often life-long, people's lives were entangled with the company in myriad ways and it became the framework of a collective identity. Thus, in an unintended way, communism acquired some characteristics of corporatism, the type of social organisation best known from pre-war Italy.¹⁶ Also in an unintended way, this collective identity served as a political basis of the anti-system movement, as was the case in Poland in 1956, and in particular in 1980-81, when large companies became the strongholds of the "Solidarity" trade union during the peaceful Polish revolution.

Eastern Europe was isolated from the western part of the continent by the Iron Curtain, and it had radically different economic and political systems. However, despite separation and differences, there were paradoxical parallels and similarities as to how social cohesion was engineered under both regimes. Of course, the western welfare state was much more sophisticated, and its political story was of a different sort, as it emerged through piecemeal adjustments, and was not imposed by a dictatorship. But in both cases, its economic basis was industrialism and high growth, its social basis was predominantly the industrial working class and its *modus*

15. Voirin, M. (1993) "Social security in central and eastern Europe: continuity and change," *International Social Security Review*, Vol. 46, No. 1.

16. Chirot, D. (1980) "The corporatist model and socialism", *Theory and Society*, Vol. 9, No. 2.

operandi was the redistribution of income. It is perhaps not surprising that with the decline of industrialism this mode of achieving social cohesion proved increasingly unworkable in eastern as in western Europe.

3. Structural change after the fall of communism

The demise of state socialism happened, in a political sense, in a relatively short span of time, between mid-1989 (the partially free elections in Poland) and 1992 (the withdrawal of the Red Army from the former GDR after the collapse of the Soviet Union). In economic and social terms, it started much earlier, somewhere at the turn of the 1970s. While the Soviet-type economies could boast relatively high growth in the 1950s and early 1960s, later the rates of growth stagnated. Soviet-type economies were incapable of moving from “extensive growth”, based on the draining of cheap labour from agriculture to manufacturing industries, to the “intensive growth”, based on the increase of labour productivity. For reasons that go beyond the scope of this paper, they did not innovate, at least outside the armament sector, and remained stuck with outdated technologies, copied from the West. This inability to innovate proved dramatic in the 1980s, when western economies were switching from industrialism to the information age.¹⁷

Stagnation produced social and political crises, to which the system responded sometimes with partial reforms, sometimes with repression (Hungary 1956, Czechoslovakia 1968 and Poland 1981). The Soviet bloc countries became also more involved in the workings of the world economy, upon which they were increasingly dependent as they needed foreign technology to sustain economic growth and development as well as imports of grain to feed their populations adequately. Whereas the Soviet Union was able to finance these imports through exports of oil and gas, the small countries of central Europe did it mostly through heavy borrowing, which in the longer run made their situation even more precarious.

These difficulties, as well as a partial opening of the world economy, were leading to cracks in the social model as based on the socialist welfare state. With full employment came inflationary pressure on wages and pervasive shortages of even basic necessities. Economic reforms increased the importance of official markets, paralleled by grey and black markets.

17. Castells, M. (1998) *The information age: economy, society and culture, Vol. I: The rise of the network society*, Blackwell Publishers, Oxford.

In some countries, repressed or open inflation contributed to the situation where US dollars and Deutschmarks took on the role of a second currency. Thus, the “marketisation” of economic life, with social consequences such as a rise in the importance of small business as well as an emergence of hidden networks linking the official and the unofficial sectors of the economy, started much earlier than 1989.

But the real and far-reaching structural changes were brought about only by the fall of state socialism. While at that time economic change was most often conceptualised as the transition to a market economy, this transformation was more complex and multidimensional, as it pushed central European economies not only towards the market, but also into the world of post-industrial capitalism and globalisation, initially perhaps with little realisation on the part of the actors involved. All central European countries, although with variations, pursued similar policies of transformation. The model of these policies was close to the so-called Washington Consensus, as practiced towards the Latin American countries in the 1980s.¹⁸ While the actual policies were designed and implemented by the local political leadership, there was a strong dose of external influence from international financial institutions, particularly the World Bank and the IMF. As some countries (for example, Poland and Hungary) accumulated large foreign debts, the support of these institutions was crucial in getting sympathy and understanding from the creditors for debt rescheduling. The most important elements of transformation were macroeconomic adjustment (anti-inflationary measures), deregulation, external liberalisation, and privatisation. While macroeconomic adjustment (price liberalisation, balancing budgets) and liberalisation and opening were, in a sense, technically easy one-time moves, privatisation has been a long-term process, not yet finished.

Privatisation has been a feature of economic changes all over the world for the last thirty or so years, from Thatcherite Britain to many less-developed countries. But the one taking place in the post-communist world has had a particular character. Before this change, almost all economic activity in these countries, from mining to manufacturing to retail trade, had been in the state’s hand. With exceptions, such as Polish agriculture, the own-

18. Williamson, J. (1990) “What Washington means by policy reform,” in *Latin American adjustment: how much has happened?*, Institute for International Economics, Washington, DC, 1990; and Greskovits, B. (1998) *The political economy of protest and patience: east European and Latin American transformation compared*, Central European University Press, Budapest.

ing of land was severely restricted. Without much simplification it may be said that the state was the only owner, the only employer and the only retailer in town. From a technical point of view, privatisation in the post-communist countries employed means similar to those in other places, as a sale of assets or shares and as managerial buyouts, with perhaps the voucher schemes being a local innovation. From a sociological, cultural, and political point of view, however, privatisation meant a revolutionary change as it triggered a wide-ranging transfer of wealth; reconfigured meanings, symbols and cognitive patterns relating to wealth, property, work, and one's social position and influenced the formation of new patterns of political behaviour.

Privatisation had obviously one important consequence for social cohesion, namely the creation of a "class" of owners. While the statistically measurable social inequalities have not risen dramatically in central Europe, the newly rich acquired a considerable visibility, particularly due to their conspicuous consumption. As there is a widespread perception that some new wealth was gained through illicit or dubious ways – either due to the privileged positions of the members of the former communist establishment, or due to corruption and crime – there is considerable resentment towards the new upper-middle class. This resentment contributes to delegitimisation of the whole transformation process in the eyes of many members of the society and fuels populist political movements.

Macroeconomic adjustment, deregulation, privatisation and the opening of the economy brought about a totally new situation for companies and, in the longer run, led to far-reaching structural changes. On the one hand, anti-inflationary measures curtailed domestic demand. On the other, the opening of the economy allowed for foreign competition. In particular, state-owned businesses were put, due to the curtailing of subventions, under financial discipline and were thus made to enforce new business strategies, similar to those of the newly emerging private sector. As the structures of central European economies were shaped by the previous investment programmes of a semi-closed command regulative system, with stress on producing capital goods, and with much of its productive apparatus obsolete, the transformation process was inevitably a painful blow to many of the state-owned companies, manifested in the form of so-called transformational recession. The dramatic drop in output was paralleled by the emergence and rise of unemployment. It took several years (about three in Poland, the most successful case) for growth to resume.

A substantial structural change followed the revival of growth. Foreign trade reoriented from East to West. Many plants, particularly in the outdated heavy industries, closed down or reduced output. Many local brand names of consumer goods (usually, of a poor quality) disappeared, while cheap Asian consumer durable goods, as well as apparel, were quickly replacing them. With the resumption of growth, manufacturing lost ground to services, while within the manufacturing sector a coexistence emerged between foreign firms producing components or finished goods with up-to-date technologies and managerial practices, and a host of small local firms – some, but not all of which proved capable of achieving quite considerable success. However, with the modern technologies and new managerial discipline, the productivity of labour rose, but the resumption of growth did not necessarily lead to a decrease in unemployment.

The overall new macroeconomic situation, as well as the microeconomic restructuring, affected the labour situation profoundly. As the “soft budget constraint” disappeared and labour became a real cost, expectations as to its quality and commitment increased in comparison with the practices of the state socialism period. Wage structure was adjusted according to market conditions, one of the outcomes of this process being the increase in those returning to education, in particular to higher education. Also, as during the restructuring period, the situation was in a constant flux – with companies opening and closing, with their profile of production changing, with old market connections severed and new ones emerging and with new owners coming – firms had, inevitably, to adapt their workforce size and structure to these constantly changing conditions. Moreover, the restructuring of the economy also gave rise to the emergence of a sizable sector of hitherto almost non-existent small- and medium-sized companies, which by nature have a high attrition rate, therefore contributing to a more fluid labour situation. Thus, on the demand side, the labour market became much more flexible than before the transformation. The emergence of previously non-existent unemployment weakened the bargaining position of workers and allowed management a relative freedom of manoeuvre in hiring, firing and setting wages, which thus could not rise faster than inflation.¹⁹

Transformation inevitably affected the situation of households. In a simplified way, state socialism guaranteed life employment and a very modest,

19. Åslund, A. (2002) *Building capitalism: the transformation of the former Soviet bloc*, Cambridge University Press, Cambridge.

but sufficient income, and it did not demand much in return in terms of labour quality. At the same time, it put consumers under the strain of constant shortages (alleviated sometimes by rationing) and offered low-quality goods and services. Now, all this has changed. Relatively quickly, the central European economies became abundant in consumer goods, but parallel to that employment became precarious while prices achieved levels comparable to those of the West. On top of that, various programmes of the socialist welfare state were being either eroded or dismantled as a consequence of the new fiscal policies of the state. The companies, due to restructuring, were shedding their welfare functions as well.

All of this does not mean that the situation of households by necessity had to deteriorate. In the long run (“the long run” being the whole transformation period of over a decade and a half), the material situation improved on average due both to the rise of per capita GDP and to the now abundant choice of goods and services. But the term “on average” says little about the situation of particular groups of households and nothing about the now prevalent feelings of insecurity. Transformation brought, of course, very substantial social costs. There has been a certain – although, in the case of central Europe, not dramatic – rise in income inequalities. There was also a quite significant increase in poverty, which touched in particular the unemployed, those locked in de-industrialising regions, women over 50, and young people with no record of previous work.²⁰

How did the households react in terms of their behaviour on the labour market? In these new conditions – a consumer paradise and partial commodification of social services on the one hand, and job shortages and new demands on labour on the other, one would expect (leaving aside collective bargaining) a pretty far-reaching flexibilisation of the labour market on the supply side. Indeed, a naked-eye observation of the labour market seems to suggest quite a vivid activity of people trying either to improve their chances in life or simply to survive. A manifestation of the attempts of the former is a rapid rise in the number of university students. On the other end of the social ladder, there is an apparently sizable market for unregistered (technically, illegal) work, particularly in domestic services, but also in construction and in small business. In between, there is a mass

20. There is a vast literature on income differences and poverty in central European countries. For Poland, see for instance, Golinowska, S. (1997) *Polska bieda II. Kryteria, ocena, przeciwdziałanie* (Polish poverty II: criteria, evaluation, countermeasures), IPISS, Warsaw; or Kowalik, T. (2002) *Nierówni i równiejsi* (Unequal and more equal), Fundacja Innowacja, Warsaw.

migration to the countries of western Europe. This had already started before the fall of state socialism (during the 1980s). During the 1990s, the migrants were looking for low-paying jobs and many of them worked outside the official labour market, usually in domestic service, construction or as seasonal agricultural workers. After the accession to the EU, some countries (Ireland and the UK) opened their official labour markets for the Poles, and the estimates are that their number has reached several hundred thousand. While most perform low-skill, menial jobs, some make it higher to the middle class.²¹

Systematic research seems to suggest, however, that the labour market is stickier than these impressions might suggest.²² According to this research, there was diminishing labour mobility between regions in Poland in the 1990s, mostly because of high relocation costs. There also was a low inter-firm mobility, except for some groups (young workers, low-skill workers and small businesses). In large firms, particularly in the public sector, mobility was much smaller than in the small private firms. This research also suggests a crystallisation of a dual labour market. One of its segments comprises the relatively stable, high-skills, high-income and high-prestige jobs. The second consists of low-skills and low-paying jobs. Those two segments show different patterns of labour mobility. Those who are active in the first type of market do not change firms often, but are ready to improve skills, to change occupations or to move to another place if there is a chance for a consequent increase in income. Those who are confined to the second market do not move far geographically, or change vocations, but change their employers quite often.

The experts who show that the mobility of labour in Poland is relatively low find barriers on the demand as well as on the supply side. For workers, it is difficult to look for new jobs because of the high costs involved (search, travel, relocation), but there are also cultural barriers in the form of passive attitudes.²³ The low labour market flexibility may be one of the factors explaining the high level of unemployment

21. Jaźwińska, E. and Okólski, M. (2001) *Ludzie na huśtawce; Migracje między peryferiami Polski i Zachodu* (People on a swing: migrations between peripheries of Poland and the West), Scholar, Warsaw.

22. Kryńska, E. (2003) "Elastyczność polskiego rynku pracy" (Flexibility of the Polish labour market), in Balcerzak-Paradowska, B. (2003) *Praca i polityka społeczna wobec wyzwań integracji*, IPiPS, Warsaw.

23. Ibid., p. 81.

in Poland. One of its components is high structural unemployment, or a lack of matches between the structure of labour supply and the demand for labour.²⁴

The obvious possible explanation of such relatively low labour flexibility is the legacy of state socialism. If people were socialised in a system where employment was easy to get and often lasted a lifetime, it would be hard for them to turn into active job-seekers. Indeed, this is supported by research showing considerable differences in attitudes and perceptions (“economic culture”) according to age.²⁵ Younger people, who are by nature more active but who also have little memory of state socialism and most of their experience in the market economy, are more prone to look actively for work. Recently, this is being witnessed by massive labour migrations to western Europe.

Finally, a question may be posed as to how the transformation affected the meaning of work. The official ideology of communism praised work as an utmost virtue, idealising manual workers and paying due respect to the contribution of the “working intelligentsia” to the overall welfare of society, while stigmatising those who evaded work as socially harmful parasites. In practice, the picture was more complex, ambiguous and nuanced. The incentive structure of the state socialism economic system – full employment and the stress on pure physical volume of output – did little to enhance the quality of work. The saying that “they pretend to pay us, and we pretend to work” reflected popular feelings as to how things really stood. But, despite all the shirking, pretending, and petty evasions, peoples’ lives were very much defined by the kind of job they held, particularly in the case of those who were the more skilled blue-collar and white-collar workers. Informal social hierarchies, as much research of the time witnessed, were related to the type of occupation. Stability of employment contributed to the creation of myriad micro-social relations and produced sets of meanings related to everyday life. Apart from

24. Cf. Socha, M. and Sztanderska, U. (2000) *Strukturalne podstawy bezrobocia w Polsce* (Structural basis of unemployment in Poland), PWN, Warsaw.

25. This is shown by current research on the Polish economic culture the author is engaged in, conducted within the project eastern enlargement – Western enlargement: cultural encounters in the European economy and society after the accession – DIOSCURI. European Community sixth framework programme (2002-2006), project co-organised by the Institute of Human Sciences in Vienna and the Central European University in Budapest.

the nation and the family, the workplace community formed the third layer of identity for people under state socialism.²⁶

Taking all this into consideration, it is not surprising that so many older people show some nostalgia for the period of state socialism, forgetting scarcity and greyness and idealising social security and stability. The meaning of work for the new generation, which is being socialised in the new, post-industrial and globalising market environment, is hard to define due to a dearth of systematic research, and what can be said here is of a hypothetical nature and based on anecdotal evidence.²⁷ Thus, the feeling that the kind of job one has defines one's position in life and society is even more a characteristic of the present situation than it was under state socialism. Work has become more cherished, as it is easy to lose and difficult to get. What seems new and characteristic for the present time is the ongoing process of individualisation. There is less of a commitment to the firm, and a loosening of bonds with the fellow workers. What people stress instead are their individual merits: the quality of work they are capable of and professionalism. Promoting one's own personal career becomes the focus of a personal micro-strategy of survival in a competitive and changing environment. Central Europe, in that sense, is undergoing the same sort of processes that the advanced western societies are familiar with.²⁸

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26. S. Nowak claimed in his seminal article ("Values and attitudes of the Polish people", *Scientific American*, 1981, No. 1, pp. 45-53) that under state socialism, which prohibited the autonomous intermediate social organisations, Poles did not develop any bonds other than those with the immediate family and the nation as a whole. The experience of the Solidarity movement, as well as the recent research of such young scholars as E. Bartha (dissertation in progress at the CEU, Budapest) or M. Mazurek (*Socjalistyczny zakład pracy* (The socialist workplace) Trio, Warsaw, 2005) gives, however, much substance to a contradictory claim that the workplace community was another reference for identities. The work of these researchers brings to light evidence not only from Poland, but also from Hungary and the GDR.
27. Much of this can be found in reporting and essays, depicting the recent work experiences in central Europe, including the ambiguous feelings of those lucky young professionals who managed to get hired by the transnational corporations.
28. Cf. Sennett, R. (1998) *The corrosion of character: the personal consequences of work in the new capitalism*, Norton, New York.

4. Structural change and social cohesion

An unequivocal and direct answer to the question on the relation of rising labour market flexibility and the degree of social cohesion in central Europe is hardly, if at all, possible, because of an overwhelming nature of changes – economic, social, political and cultural – following the fall of state socialism, all of them impinging upon social cohesion. Isolating the influence of each of these factors is almost impossible.

Flexibilisation of the labour market is an important, but by far not the only result of economic change, which produced its “winners” and “losers”. The winners are those who are better educated, live in urban centres as well as the members of the former establishment, who were able to convert their political capital into economic capital.²⁹ The losers were many blue-collar workers of the former state-owned companies, people stuck in villages and small provincial townships, female blue-collar workers, semi-skilled white-collar workers, small-holding peasants and the Roma. However, one should beware of idealising state socialism when assessing the social costs of transformation, regardless of less social stratification and more social security. State socialism did not so much liquidate social and cultural differences within a society, as it glossed over them through job security and the primitive, albeit comprehensive welfare state. Once these were gone, all kinds of historically accumulated social and cultural differences came to the surface.

One group of losers, which deserves closer attention, is the traditional industrial working class. Their story is paradoxical. This group was, in a large measure, a creation of socialist industrialisation, and it became an idolised and romanticised symbol of communism’s historical success. In Poland, however, it became restless and, in 1956, 1970, 1976 and 1981-82, overtly militant. The “Solidarity” movement, in the early 1980s and then, in a revived form, at the end of the decade, acted in a large measure according to its name. Yet, once state socialism collapsed, the way the shock therapy transformation was designed, it worked very much against the immediate interests of industrial workers. That prompted accusations that the intellectual elite, an ally of the workers in their resistance to communism, had abandoned or even betrayed them, while keeping for

29. On the latter question see, in particular, Eyal, G., Szelenyi, I. and Townsley, E. (1998) *Making capitalism without capitalists: the new ruling elites in eastern Europe*, Verso, London and New York.

themselves the fruits of the change.³⁰ But while perhaps the transformation indeed might have been smoother and more gradual than it was, it is difficult to maintain that the trauma of moving from industrialism to post-industrialism could be easily evaded at that moment or another. Most of the highly industrialised countries had to endure it as well.

But economic change is only part of the story. Equally important is the cultural change, first and foremost related to the unprecedented opening of central Europe to the West. While the elite culture of this region has been definitely western for the whole millennium, the large mass of society – predominantly peasants until the Second World War, and industrialised and urbanised only under communism – had little direct contact with the West. With the fall of communism, this changed dramatically, with western liberal political ideas, secularism, sexual tolerance, consumerism and mass culture coming to every doorstep. While these concepts were easily accepted by urban upper-middle classes and parts of the intellectual elite, they challenged the established perceptions of the world of the older generation, of less-educated people or of those living far from large cities. Indeed, for many these challenges seemed to threaten their identity of, for example, traditionally religious and fiercely patriotic Poles. These cultural influences and changes – interpreted in different ways by the more liberal, and by the more conservative members of central European societies – were thus contributing to the deterioration of social cohesion. The Polish case is illuminating once again. The Solidarity movement of 1980–81 had been built upon the myth of the unity between the workers and the intellectuals. After a decade and a half of transformation, the chasm between the western-oriented, liberal-minded intellectuals and upper-middle classes on the one hand and traditional conservative lower-middle and working class members on the other seems unbridgeable. Moreover, among the latter a combination of economic and cultural frustrations may encourage political behaviour inimical to social stability.

Much depends, however, upon the possibilities of political mobilisation and of an emergence of new ideologies, challenging the system which emerged after the fall of state socialism. The possibilities of mobilisation seem to be hampered by the lack of stability of the political scene. The replacement of a monolithic, authoritarian system of late socialism by a pluralist democracy led to a new dynamic in political life, characteristic for nascent, not well-established democracies. While the change of regime

30. See Ost, D. (2005) *The defeat of solidarity: anger and politics in post-communist Europe*, Cornell University Press, Ithaca, NY.

allowed for social self-organisation and the articulation of ideas and interests, the deeper conditions for a stable and consolidated democracy have been far from fulfilled.³¹ As a result, the collective actors – unions and parties in particular – have little stability. Trade unions played an important role up to a point, but with the progress of privatisation and the rise of unemployment, their role diminished. They are absent in small businesses and hardly visible in foreign-owned firms. Their strongholds are the state-owned companies and public services, where they represent the corporate interests of some professions, for example teachers. Also political parties, particularly in the Polish case, have little stability, as each of those who gained some importance was later swept out of the political scene.

Political mobilisation depends also upon ideologies offering the electorate a convincing interpretation of the state of affairs, and an attractive programme for the future. The post-communist transformation produced various ideological responses. One of them was an initial embrace – particularly by the better educated groups of society – of some variations of neo-liberalism. The central European economic liberals were often critical of the western European welfare state, perceived as inefficient, ineffective, and too costly to be introduced in the context of the transforming countries, much poorer than the societies of western Europe. In practice, the radical pro-market rhetoric was toned down by open and tacit social policy measures, intended to pacify restless groups. Despite this, the social costs of transformation led to a rise of hostility to radical market change. As a result, the other ideological response was a stress on social sensitivity. But as the governments that focused on the importance of markets were preserving elements of social protection, those preaching social sensitivity tried to conform to the principles of fiscal prudence and did not change much in the overall economic strategy, in the centre of which has been monetary stability. The discrepancy between the promises and practice might have been one of the reasons for the fatigue with political parties, and for a withdrawal on the part of the public from politics.

The failures of neo-liberal and social democratic ideologies led to an emergence of conservative, nationalist populism. Its stress is on national identity, on the importance of religion and the family, on social solidarity and on the need of morality in public life. The right is Euro-sceptical, seeing the EU as an association of nation states, which by necessity have opposing

31. Cf. Linz, J.J. and Stepan, A. (1966) *Problems of democratic transition and consolidation: southern Europe, South America, and post-communist Europe*, The John Hopkins University Press, Baltimore.

interests. While not opposing modernisation, the conservatives treat it selectively and want to combine it with a strengthening of traditional values. This message seems to find a captive audience, as it addresses issues which are painful for many, such as social insecurity, but also fast social change and such cultural phenomena (perceived as coming from western Europe), as secularisation, feminism or gay movements. High on the agenda of the right is the fight against corruption, which is being portrayed as caused primarily by hidden networks, manipulated by members of the former communist establishment.³² In terms of social cohesion, the new right is somewhat ambiguous, as while it stresses national solidarity, it is also militant in language and hints at excluding those who do not deserve the name of true patriots.

The political programme of the conservative right, sympathetic to soft authoritarianism, is outdated. At the same time, it sends a clear message that social cohesion matters, something the advocates of neo-liberal transformation seemed not to pay much attention to. It does not mean, however, that the conservative right has much to offer in terms of practical policy solutions, and this is probably why so much attention is paid to national symbols and to the fight with real and imagined corruption. However, the fact that social cohesion is at the centre of the right's attention, and that other ideological currents and political movements neglected this issue, may secure for the political right some public sympathy in the time to come.

5. Concluding remarks

Under the late stages of state socialism, social cohesion in central Europe had been maintained by a combination of mild nationalism and social policies, aiming at securing a modicum of equality and easy access to the elementary means of existence. After the fall of this system, social cohesion is indeed deteriorating, as manifested both by the statistical indicators as by the patterns of political behaviour. There are increasing income differences, increasing poverty and signs of social exclusion. Also, frustration with the market changes as well as hostility towards the newly rich have developed. Populist and radical rightist political ideological movements have gathered some sympathy among the frustrated groups of society.

32. Krastev, I. (2004) *Shifting obsessions: three essays on the politics of anticorruption*, CEU Press, Budapest.

Flexibilisation of the labour market, and changing labour relations in general, are among the reasons for this deterioration. In this respect, the processes taking place in central Europe are similar to those produced by technological changes and by globalisation occurring elsewhere. As in other European countries, there is a decline of the industrial working class, and an emergence of new types of labour relations and social structures. The difference is that, in the case of central Europe, these changes are more rapid, more radical and more dramatic. As they affect various groups of post-communist societies in an uneven degree, these societies acquire a somewhat dual character, with a socially better equipped minority living in the advanced, post-industrial reality. Apart from economics, other reasons for the deterioration of social cohesion in central Europe are of a cultural nature. The collapse of state socialism opened them to massive and unprecedented cultural challenges, including a variety of often conflicting world views and value systems. While some social groups welcome this opening, others perceive it as a threat to their established identities and look for the ways to contain them.

The dual character of the central European societies has a direct linkage to the questions of social cohesion and market flexibility, as it produces different value systems and modes of perception, and as a result makes consensus difficult with regards to desired institutional change. Simplifying, one may say that two different epistemological and axiological systems function side by side. One uses the language of individual liberty and responsibility, of market efficiency, and of an inevitability of globalisation. There is little appreciation for the issue of social cohesion within such a perspective, the need for greater labour flexibility is treated as painfully obvious and economic growth is regarded as a solution to most social problems. The other system talks about solidarity and community (increasingly, as is the case in Poland and Hungary, of the national community), about a community's responsibility for the welfare of its weaker members and about the need for a regulatory role of the tradition and the state. Implicitly more than explicitly, social cohesion is an important part of this *Weltauschaunung*. There seems to be little in common between these two perspectives, and thus talking about one characteristic vision for central Europe is difficult.

Given, however, the extent and the rapidity of economic, social, political and cultural change after the fall of state socialism, the corrosion of social cohesion and the resulting political instability have not acquired a dramatic scope. Altogether, for central Europe the transformation – as compared with many other post-communist countries – has been a remarkable

success, despite the social costs it incurred. Nevertheless, maintaining social cohesion remains a challenge for the future. There are no easy answers to this challenge. In contrast to the rebuilding of economic institutions such as businesses, banks, or corporate governance, there are no good models to follow in social policies. The western European welfare state, a tremendous success in the post-war years, has problems of its own and requires a lot of rethinking and restructuring itself. Moreover, the main actor in the reform process in central Europe, the state, is weak in terms of its infrastructural power, often unable to spell out the priorities of reforms, as well as to administer the reforms already decided. Finally, the public debate on the issues involved – while quite vivid – is often poorly informed in the technical sense and too entangled in current politics and games of interest groups.

All this does not mean that nothing can be done in terms of policies, at local, regional, national and European Union level, only that there are no simple, ready-made and universal solutions. First, and rather obviously, on the agenda is the necessity of close monitoring of the issues of social cohesion, and of building public awareness of the importance of these issues. With regard to monitoring, much is done in western Europe, increasingly more in central Europe as well. But there is room for improvement, particularly in terms of the performance of the agencies responsible, and of technical standards of data collection and aggregation, however, western patterns have to be adjusted to local conditions. Building public awareness is a more difficult challenge, as the contentious nature of these problems easily leads to their use in various kinds of populist political games. But a hope that politicians and governments may behave in a responsible way should not be abandoned.

The second point, directly linked to the question of labour market flexibility, is a necessity to reshape social policies in such a way as to make them more compatible with these new forms of labour relations. The welfare systems both in western Europe, and in central Europe – however different – were developed in the context of the industrial Fordian model, on the assumption of full-time, lifelong stable employment. This is not the case any more. Thus, welfare packages, particularly the pension schemes and health care provisions, should be redesigned in such a way as to make them more “portable.” They should take into consideration that increasingly a person is likely to change not only jobs, but also professions and countries of residence, as well as that such a person may remain out of work for some periods or turn to a part-time or temporary employment. This redesign should work to prevent too many people from being totally

out of the social insurance system, as that would mean that they would not contribute financially to its operation, while in the case of an emergency they would be using the public resources anyway. Also, the transaction costs of moving welfare packages should not be too high, as that would hamper labour flexibility or would push people out of social insurance. While all this is not easy, as current social policies consist of a myriad of regulations and entitlements, many of which are bitterly defended by the well-entrenched interest groups, it is possible, but it requires patience, persistence and a sense of direction.

The third rather obvious point on the agenda is education, particularly (but not only) at the very early stages. Young people should be socialised in such a way as to make them prepared for the life in a market environment, while also sensitive to the fact that they are members of a community – or rather, increasingly, members of many communities at any given moment and throughout their lives. Educational institutions thus have a responsibility not only to transmit knowledge, but also to teach, or rather to instil and train social skills and social sensibility, enhancing – to use Amartya Sen's concept – capabilities of individuals. Overall educational reforms are long-term endeavours, and thus are not easy to start due to the mechanics of the political cycle. But piecemeal change is possible, and there is evidence that, here and there, it is beginning to happen.³³

33. A case in point may be the huge popularity of the Polish variation of the American Junior Achievement Program, training school kids in a broadly understood entrepreneurship.

III – Towards reconciliation of labour flexibility with social security and cohesion in central and eastern Europe

Sandrine Cazes, Senior Specialist, Employment and Labour Market Policies, International Labour Office (ILO)

Alena Nesporova, Vice Regional Director for Europe and Central Asia (ILO)

Introduction

Newly emerging technologies as well as changes in the world and domestic markets are pushing companies to adapt rapidly their production patterns and costs in order to survive and expand in competition with others. This also concerns labour as the company may need skills different from those of its workforce and must invest in their training or replace them, and/or it may be faced with the necessity to reduce labour costs through employment terminations, working time reductions or wage cuts. All these types of adjustments incur additional costs and this is the reason why employers call for labour market flexibility, which would make these adjustments faster and cheaper. However, responding to companies' need for flexibility, without considering the importance of having stable and secure labour markets, would be socially inefficient and could even have adverse effects on economic performances (such as labour productivity), besides the negative effects at the individual and household levels. Moreover, there is a lot of controversy as to the relationship between labour market flexibility and the overall labour market situation. In particular, international financial institutions and some liberal economists see higher flexibility as the solution to poor economic and employment performance and call for the liberalisation of labour legislation and the weakening of labour market institutions and policies. Other international institutions and labour economists challenge the allegedly negative role of legislation on labour market performance and call for the strengthening of labour market institutions and policies. In this context they call for a better combination of flexibility and security or "flexicurity".

This article will first explain the concept and main elements of flexicurity. Second, it will summarise our findings on the main challenges faced by the labour markets of central and eastern European countries during the 1990s and to what extent they were affected by changes

in labour market institutions and policies. Third, we will compare these results with those from a similar analysis undertaken for the period after 1999, with the aim of revealing whether the differences between the Organisation for Economic Co-operation and Development (OECD) and the central and eastern European countries have remained, diminished or even increased. The last part provides some policy conclusions from our analysis.

1. The concept of flexicurity

The term “flexicurity” stems originally from a Dutch law (*Wet Flexibiliteit en Zekerheid* from 1999) that provides prospects of permanent employment to temporary agency workers after two years of temping, and thus links employment security with flexible assignments of staff. However, the term has been extended to mean in general labour market settings that provide security for more flexible employment relations. The extended concept implies a trade-off between employment security, provided at the firm level through employment protection legislation and collective bargaining, and protection provided through the social protection system in the form of unemployment insurance and active labour market policies. The flexicurity approach advocates some rearrangement between protection at workplace and social protection outside companies to allow for the optimal combination of labour market performance and a worker’s security, which do not come at the expense of economic performance (see Auer, Berg and Coulibaly, 2005). However, there is no one-size-fits-all flexicurity model and different combinations between employment protection in the workplace and social protection provided outside companies (also with different forms of social protection – for example combinations of active or passive labour market policies) might produce results, acceptable for all parties concerned, depending on the country’s culture, traditions and the political situation.

Both employment protection and labour market policies are important in providing security to workers. In labour markets exposed to globalisation, employment protection is often hard to maintain and lay-offs tend to occur frequently. Labour market policies are then helping to limit the larger effects of a lay-off on individual income loss and therefore on consumer spending and aggregate demand growth. Another fundamental role of labour market policies is to ensure that labour market transitions are more protected, allowing for mobility in the labour market. Workers should not feel locked into a poor quality job out of fear of having no other option; or feel that they must take the first job available because

they are without social protection. Similarly, firms should not be burdened with high dismissal costs when they are themselves in trouble and have to adjust their workforce to changing market conditions.

Labour market policies are divided into two groups: passive and active. Passive policies provide replacement income during periods of joblessness, which usually include job search provisions but may also be made conditional upon joining a training or work programme. Active policies aim at labour market integration through demand or supply measures. They can include job training, job placement services as well as employment subsidies that stimulate the creation of additional jobs. Both passive and active labour market policies provide security during labour market transitions and should be used during different phases of joblessness, with passive income replacement and job search in the beginning of the unemployment period and active measures taking over to prevent the occurrence of long-term unemployment.

Tripartite social dialogue is instrumental in designing and implementing effective flexibility cum security programmes. Unions are concerned about the employment security of their members but will accept changes in protection at the firm level for adjustment purposes, if credible compensatory protection through the social protection system is provided. Employers are concerned by their increased adjustment needs, but will also buy in to improved social protection for those laid off. The state in turn will provide a stronger and more effective social protection system, when it results in better adjustment and better reallocation of workers, and more security throughout the economy, also because of the macroeconomic effects that micro-agents might not be concerned with. A case in point is training: negotiating the training needs of workers and firms, with the state providing efficient policies and institutions, could reduce the incentive problem inherent in specific training provided by firms, as in the absence of negotiation and institutions, firms could be hesitant to train workers beyond the strict necessary, out of fear that s/he may leave the firm, or be poached by a competitor. Social dialogue can also be used to enhance functional flexibility. Through constructive labour-management relationships, firms can more easily adopt technologies to increase productivity, since provisions for union approval no longer become a hurdle to implementing productivity-enhancing change. Flexibility that comes about collectively as opposed to unilaterally without consultation with workers is better for productivity, since it adds legitimacy. Tripartite is also important for financing labour market policies, since it ensures that costs of the policies are shared among workers, employers and the state.

Flexicurity policies can be observed in national and international governance systems: in the EU Lisbon strategy¹ and the ILO Global Employment Agenda, in the systems currently used in the Scandinavian countries, in Belgium and in Austria. In each country, a different emphasis has been put on the types of flexibilisation and security, as both are multidimensional concepts. In Denmark, for instance, there is a clear trade-off between a high level of external-numerical flexibility and a high level of income security. Danish workers have little protection against dismissal, but with income protection they have the security of being able to find a new job quickly, through wide access to training, mediation and reintegration. The Austrian approach has been characterised by a strong emphasis on active labour market policies, involving a shift from job security to employment security: there, employability of the workforce has become a crucial factor, to enhance flexibility through security. Moreover, the Austrian tradition of social partnership, which relies on a well-organised dialogue between the social partners, has smoothed the process of adaptation and helped promote the flexicurity concept.

2. Central and eastern European labour markets in transition: flexible but jobless²

The process of economic and social reforms that began in the early 1990s in central and eastern Europe has had a profound impact on the functioning and adjustment of the labour markets in these countries. Before transition, businesses were not exposed to international competition and workers enjoyed extremely high employment protection, job security and stability. With the opening to global markets at the beginning of the 1990s, companies were forced to adjust their inputs – including labour and production technology – and their outputs to market demand. Labour market flexibilisation was thus seen as part of a necessary adjustment process and it was broadly accepted that full employment and the generous social protection systems could not be maintained any longer. The policy prescription extended in the region – strongly advocated by the international financial institutions – was thus very much in line with

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1. For European policy makers, “flexicurity” has been increasingly seen as a way to preserve the European social model, which has its foundations in a shared commitment to economic prosperity, social cohesion and solidarity, health-care and education systems that are accessible to all, as well as a broad and reliable social welfare system and social dialogue.
 2. This part is based on Cazes and Nesporova (2003).

the orthodox view of the labour market: employment protection legislation (EPL) was amended leading to a substantial moderation of workers' protection; and unemployment insurance schemes, while very generous at the beginning of transition, were severely reduced in terms of the level of benefits, eligibility conditions and length of payment.³ Nevertheless, low activity and employment rates, persistent unemployment and alarming levels of long-term unemployment remained major challenges in most countries of the region. While it was first argued that the poor employment outcomes were due to slow economic recovery, there is now growing evidence that even in those countries where economic growth has since recovered and has remained relatively high over a longer period, labour market outcomes have not followed.

We explored in detail to what extent the labour markets of the central and eastern European countries adjusted and became more flexible over the course of the 1990s. As to changes in the characteristics of employment, a significant upsurge in flexible forms of employment has been found and this is mainly in the form of people holding multiple jobs or second jobs, both formal and more frequently informal (held in addition to primary employment, registered unemployment or formal inactivity). Also the incidence of temporary employment rose significantly but more as non-labour contracts rather than fixed-term or short-term labour contracts. Using micro-level data, we also analysed the job reallocation process and workers' transitions between labour market statuses. Our findings demonstrated that labour market flexibility measured by labour turnover intensified in connection with company restructuring and that it fluctuated with the economic cycle.

Another important result of our analysis was the counter-cyclical behaviour of labour turnover, in contrast to the pro-cyclical pattern of economically advanced (in this case OECD) countries. We explained this result by depressed demand for labour but also by workers' behaviour, which was different in the central and eastern European and OECD countries. In the former, the weakening of workers' rights, the reduction of employment and income protection and more generally perceived high insecurity meant that workers were reluctant to quit their jobs voluntarily, even during an

3. According to the orthodox theory, generous income support influences labour market performances in two ways: it discourages the unemployed from seeking jobs (by increasing their reservation wage) and it reduces the "fear" of being unemployed, hence increasing the upward pressure on wages from employees (through the trade unions, for example).

economic upswing.⁴ We also examined regulatory constraints faced by employers: amendments to employment protection legislation were clearly inspired by labour legislation reforms in economically advanced countries, in particular the EU-15 countries. Using methodology developed by the OECD (1999), we provided a summary EPL strictness index for the region for the late 1990s. We found that on average, EPL was similar to the EU-15 average and slightly above the OECD average. However, the weaknesses in labour market institutions and collective bargaining, combined with poor law enforcement, contributed to high labour market flexibility and perceived job insecurity.

Finally, we tested the possible effects of labour market institutions and policies on the labour market performances of CEE countries. We built on work done by Nickell (1997), Nickell and Layard (1999) and the OECD (1999) and conducted an econometric analysis; we looked at the impact of EPL, unemployment benefit systems, wage-setting institutions, active labour market policies (ALMPs) and payroll taxes on labour market outcomes. The main result of this empirical research for the end of the 1990s was that the EPL strictness had no statistically significant impact on unemployment (aggregate, youth and long-term) in CEE countries, but was significantly correlated with the level of the participation rate, suggesting that more protection could increase labour force participation in the (formal) labour market. The explanation for this should be sought in the widespread non-observance of labour legislation as well as in the significant amount of informal employment. ALMPs and collective-bargaining coverage were the labour market institutions that had an impact on enhancing labour market participation and employment and on lowering unemployment, youth unemployment and long-term unemployment over the period. In addition, all three unemployment indicators tended to increase with higher labour taxation.

It can thus be concluded that the deregulation policy conducted in central and eastern Europe did not improve labour market performance and even led in some countries to adverse effects on labour force participation – which had once been among the highest in the world, but is now below the OECD average – and on employment and labour reallocation.

4. This finding was also supported by a strong correlation between economic cycle and labour market flows data, such as moves from employment to unemployment or inactivity for the majority of the central and eastern European countries studied by the authors.

3. How did central and eastern European labour markets adjust after 2000?

As the new EU member countries from central and eastern Europe consider their transition process completed, we decided to reproduce the pattern of analysis used for the 1990s also for the period immediately following 1999, to analyse the nature of changes in labour market institutions and policies. The analysis focuses on the 11 new EU member and candidate countries (EU8+3). Our results are summarised below.⁵

First of all, we found that economic growth has indeed accelerated in the region and coincides with declining unemployment. However, employment increased in only five of the EU8+3 countries and even there only modestly so that one should still speak about jobless growth across the region. The fall in unemployment continued to feed inactivity more than employment: labour market participation has continued to decline in the majority of these countries, including two of the five countries with improving employment performance.

The share of temporary employment has accelerated. However, in contrast to the 1990s, it has taken the form of fixed-term and short-term contracts rather than civil contracts, which were reduced as a result of a stricter stance taken by the labour market and financial institutions in many countries. In contrast, part-time employment remained limited in most countries except among young and old workers, at least some of whom may actually prefer to combine part-time employment with study or leisure time (youth) and old-age or disability pension (the elderly). Contrary to the 1990s, multiple-job holding has declined in the majority of these countries. Although data on informal employment are scarce, they also indicate a certain contraction in informal employment.

Labour turnover has declined since 2000 in all the countries for which we have data, indicating a certain stabilisation of their labour markets. Both accession and separation rates have fallen, which suggests that companies are no longer resorting to mass redundancies (or forced “voluntary resignations”) but are still unable to create many new positions, and employment performance remains poor. This explains the continuing perception of high employment and job insecurity, as indicated by the continuing tendency towards a counter-cyclical development of labour turnover that

5. This and the following chapters are based on our forthcoming book, Cazes and Nesporova (2006).

we have found. During economic upswings workers are less ready to quit their jobs voluntarily for newly created ones since the job creation capacity of the economy is low and people do not trust the stability and quality of new jobs. In turn, during economic recessions companies struggle to survive; they strengthen their competitiveness by increasing labour productivity and cutting labour costs, including downsizing the workforce.

The trend towards EPL liberalisation, which started in the 1990s, has further continued. In 2003, EPL in the EU8+3 countries was on average more liberal than that of the EU-15 countries, although still less so than the average among the OECD countries. Nevertheless the differences are minimal. Our analysis has also shown that EPL strictness had no statistically significant impact on labour market participation, employment or unemployment. Calls for further labour market deregulation through the liberalisation of EPL in the hope of increasing employment and reducing unemployment would thus appear not to be substantiated. With regard to increasing labour productivity and reducing production and labour costs – considered a priority by employers – deregulation itself does not lead towards higher recruitments, nor does it improve the labour market situation.

There have been important developments in other labour market institutions and policies. Protection at the workplace has decreased not only as a result of more liberal regulation of employment termination but also because levels of unionisation and coverage of workers by collective agreements have declined in the sub-region. Employment security outside the workplace has been strengthened in the majority of the EU8+3 countries by improving passive and active labour market policies. Many passive measures serve to reduce the labour supply, particularly of those individuals with problems of re-entering the labour market. Another challenge is the low degree of co-ordination within the workers' and employers' movements and their insufficient capacity to deal with labour market issues, which significantly limits the role of the social partners in formulating and implementing effective labour market policies, despite formal mechanisms in place for their involvement. Finally, labour taxation has been reduced in the sub-region but still remains well above the average of the EU and OECD.

The multivariate analysis of the effects of labour market institutions on the main labour market indicators displayed partially different results from those for the 1990s. First of all, no difference was found between the EU8+3 and the OECD countries for the factors explaining labour market participation, employment and unemployment. This would indicate

a generally convergent development, certainly strengthened by the EU accession process. The correlation found in the 1990s between EPL on the one hand and employment and labour market participation on the other has become statistically insignificant. The significant impact of collective bargaining on the level of labour market participation, employment and unemployment identified in the 1990s has now disappeared. However, for youth unemployment and long-term unemployment our results show a negative effect of trade union density. This suggests that the strong protection of core workers by trade unions seems to work against recruitment or may lead towards more lay-offs among less competitive workers and thus contribute to higher youth and long-term unemployment.

ALMPs have further strengthened their positive effect on promoting economic activity and employment and reducing overall, youth and long-term unemployment in comparison with the end of the 1990s. In contrast, we have found that high payroll taxes seem to contribute not only to higher unemployment but also to lower labour market participation and employment. The analysis also indicates that longer duration of payment of unemployment benefits has a negative impact on reducing economic activity and employment and on increasing youth and long-term unemployment. This reflects the considerable difficulties experienced by young people, low-skilled, older workers and others in finding employment in a situation of persistent low demand for labour. These individuals are then forced to stay on unemployment benefits as long as possible while in fact many of them are passive job-seekers and thus inactive.

4. Policy conclusions

The most important objective of employment policy in the region is to address the challenge of jobless growth. It must endeavour to translate economic growth into positive and sufficiently high net job creation that results in higher, good quality employment. This calls for a sound, balanced macroeconomic policy, which would stimulate sustainable economic development through interventions on the supply and demand sides of the economy.

Sound macroeconomic policy undoubtedly contributes towards stimulating economic growth and business development. However, for it to create more and better employment opportunities for the population and for all social groups to have equal employment opportunities, macroeconomic policy has to be combined with effective employment and labour market policies. There are also important skill mismatches, which are pushing low-

skilled individuals, individuals with skills no longer in demand and young people without work experience into unemployment or out of the labour market. Therefore reforms of the national education systems should focus on increasing the educational and skills level of the population, but should also create conditions for the continuous adjustment of skills, along the principle of lifelong learning through universal, high-quality general education and equity in access to higher education.

As advocated in the introduction, the combination of flexibility and security has both an economic and social rationale. Our review of development of the main labour market institutions and policies after 2000 and their impact on labour market outcomes shows that even though labour legislation has been quite liberalised, weak enforcement remains an important challenge. In addition, a number of employment protection and promotion issues, which go beyond the basics provided by legislation, could be effectively tackled by collective bargaining. This would, however, require strengthening social dialogue, especially at the sectoral and regional levels and enhance the social partners' ability to build capacity.

High payroll taxes, despite their recent slight reduction in many countries of the sub-region, have been identified as one important factor of unfavourable labour market performance and as contributing to higher informality of employment. Governments should therefore consider their further reduction while shifting some social expenditure to general taxation and improving tax collection.

Another factor negatively affecting labour market performance is the duration of payment of unemployment benefits. This might appear to invite a stricter stance on unemployment insurance schemes, in particular for vulnerable groups. However, since the main problem lies not in the generosity of unemployment benefits in the region, which is low compared with the EU-15 average, but rather in the lack of employment opportunities for less competitive workers in a context of persistent depressed labour demand, the solution should be sought in an activation strategy. Public employment services should pay much more attention to harder-to-place persons, understand their specific obstacles to employment and address them through individual employment plans. Such plans would include intensive job placement assistance and/or training, placement in temporary subsidised jobs, vocational rehabilitation or other assistance according to their needs. Measures could also include incentives for workers, such as premiums for those who find jobs very early, and for employers, in the form of wage subsidies, grants or tax deductions.

The impact of ALMPs on increasing economic activity and employment and reducing aggregate, youth and long-term unemployment seems to have further strengthened since the 1990s. Although ALMPs alone have only a limited capacity to create new employment, their main contribution is in expanding the labour supply and improving its quality, facilitating labour market transitions, reducing labour market imbalances and cutting frictional and structural unemployment, and addressing equity problems as described above. This reinforces the importance of active intervention in the labour market required by the European Employment Strategy. The extent of ALMPs should be broadened to reach all job-seekers in need of assistance and their application should be fine-tuned to provide appropriate but also cost-effective assistance for successful re-employment.

The search for a better combination of flexibility and security has been increasingly emphasised within the EU as being indispensable for improving competitiveness and at the same time maintaining the European social model. Our analysis has confirmed the relevance of the flexicurity approach also for the central and eastern European countries, which require appropriate reforms of both their labour markets and institutional frameworks as well as their education and social security systems as suggested above. This human development and employment activation strategy, in combination with decent income support for those actively looking for jobs or unable to work, is of course not cheap. Even if the limited available funds were to be used in the most effective way, they would need to be increased, in particular in those countries with a high level of unemployment. In the face of the current pressure to reduce public budgets and maintain the balance of public finances within the Maastricht criteria, such a recommendation may look unfeasible. However, this issue is not one that should be left to politicians to decide alone; it should become the subject of social dialogue. It is up to the government together with the social partners and representatives of vulnerable social groups and jobless persons to determine their country's employment and social development. Through dialogue, they must decide whether the country will accelerate its development in line with the EU Lisbon Strategy and the ILO Decent Work Agenda towards a triple objective of full and decent employment, high labour productivity and social coherence and inclusion, or whether it will remain driven by predominantly economic goals.

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PART II – ISSUES AND SPECIFICITIES OF CENTRAL AND EASTERN EUROPE

I – Flexibility and the globalisation challenge: which way forward for transition countries?

Sanja Crnković-Pozaić, former Director of the Croatian Employment Service

1. The challenge

Any economy in an increasingly global setting, especially economies in transition, need to be able to adjust and restructure with adequate speed and at the lowest possible cost. The imperative of fast change has been explicated from undergraduate to specialised high-powered courses all over the developed world in accordance with the last of the staunch defenders of the neoclassical creed, which is making its last stand against new people-oriented policies and strategies. Flexible forms of work have been declared a must, since they alone seem to be the answer to employers' needs to remain flexible and to adjust to changing circumstances. At the same time, everyone is paying lip service to theories of human-resource development, which is supposed to be the ultimate competitive advantage in a knowledge-based society. These two threads are not good bedfellows and they beg for some analysis. Some of the questions which come to mind are:

- Does the fact that the employer can easily and cheaply fire a worker increase his or her willingness and capacity to create new jobs?
- Is the employer more motivated to hire more staff simply because it is cheap to lay off a worker?
- Is a laid-off worker more mobile than an employed worker?
- Does the fact that women appear to mix work with family life, with the latter keeping the priority position, mean that women prefer to work in short-term, often unstimulating jobs with no career prospect?

On the other hand, management gurus speak of the new paradigm in business. Self-organising firms, knowledge management and the learning

organisation are concepts which depend very much on the value of human capital in successful business solutions. The main challenge could thus lie in the answer to the following questions:

- If people are the prime source of business excellence, how stimulating is an environment in which you can find yourself on the street easily?
- Can uncertainty, insecurity and fear be the driving force of a people-oriented business of tomorrow?

The past decade has taught us several lessons. Firstly, healthy economic growth can coexist with growing unemployment which is, for many, a one-way street to poverty. Flexible forms of work have not helped get the army of unemployed back into the workforce. Target levels for participation rates which have been set in the EU employment strategies are being reached with the help of international employment criteria, namely an hour of work in the reference period. The incidence of flexible work forms does not necessarily satisfy this requirement unless participating full-time equivalents are taken into account. Rigid labour legislation and the welfare state are blamed for low mobility, requests for subsidies and an unwillingness to accept available jobs; however, the dismantling of both in the last decade did little to improve chances of finding employment for many vulnerable groups. Active labour market policies (ALMPs) became popular and have been fine-tuned to reduce the well-known deadweight and substitution effects which were typical of the first-generation employment policies. Huge expenses were incurred before “activation” became the magic word. Preparation for the job search, bolstering self-confidence, boosting skills and other remedies are now combined with the usual ALMPs and both design, monitoring and evaluation methods are becoming more and more refined. How well do these remedies work in transition countries?

2. The Croatian labour market: how specific is it?

The labour market in Croatia is currently in a period of fundamental change. The recent change in labour legislation, the reduction of the fiscal burden, institutional capacity building and the initial attempts at facilitating better social dialogue and competency in designing efficient policy measures all came about simultaneously, causing considerable change in the system.

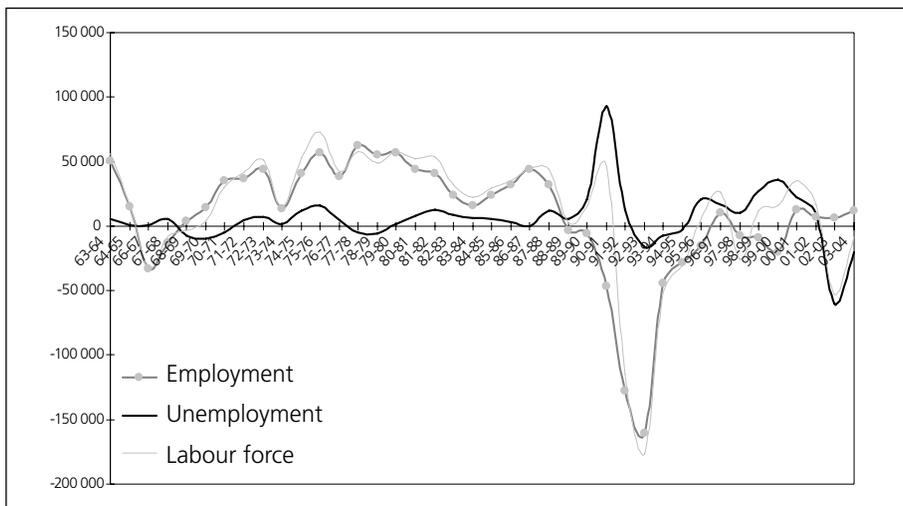
This change is happening in a period when a fall in the number of unemployed has been registered by the International Labour Office concurrently with a shy but sustained increase in the employment rate. The positive macroeconomic environment can largely be attributed to an increase in industrial

production, tourism services, rising consumption and the increasing importance of investment expenditure. A considerable share of the latter is government investment in infrastructure, namely roads and housing construction.

The Croatian labour market is segmented, relatively undeveloped with a low level of spatial and intersectoral labour mobility, but an increasing turnover of both labour and jobs. On the one hand, there is the relatively inflexible formal sector which is regulated by the national legislature and on the other, a flexible informal sector, one part of which is legal but unregistered and the other both unregistered and illegal. The two segments are intertwined and react to policy measures as combined entities – increasing rigidity and the lack of formal sector jobs result in the creation of more informal sector activities.

Long-term movements of employment and unemployment in Croatia demonstrate the well-known characteristics of a transitional economy with some specific features relating to the aggression by Serbia and Montenegro and its aftermath. The following graph shows the trends in major labour market movements in Croatia over the last forty years.

Chart 1 – Annual change in employment, unemployment and the labour force in Croatia (1963-2004)



Sources: CES,¹ CBS² and author's calculations.

1. CES – Croatian Employment Service.
2. CBS – Croatian Bureau of Statistics.

During the socialist period, employment grew steadily with oscillations linked to the liberalisation reforms of the 1960s and the oil crises in the 1970s. Unemployment did not seem to be related to movements in employment to any large extent. In fact, increases in employment were usually accompanied by increases in unemployment³ as the labour force grew, fuelled by new job opportunities. It is interesting to note that the fall in employment and the rise in unemployment started at the end of the 1980s and were, in fact, only deepened by the transition and the war. At that time, the former Yugoslavia was experiencing a deep recession, which had lasted some time, and this probably contributed to the build-up of aggression in the country.⁴

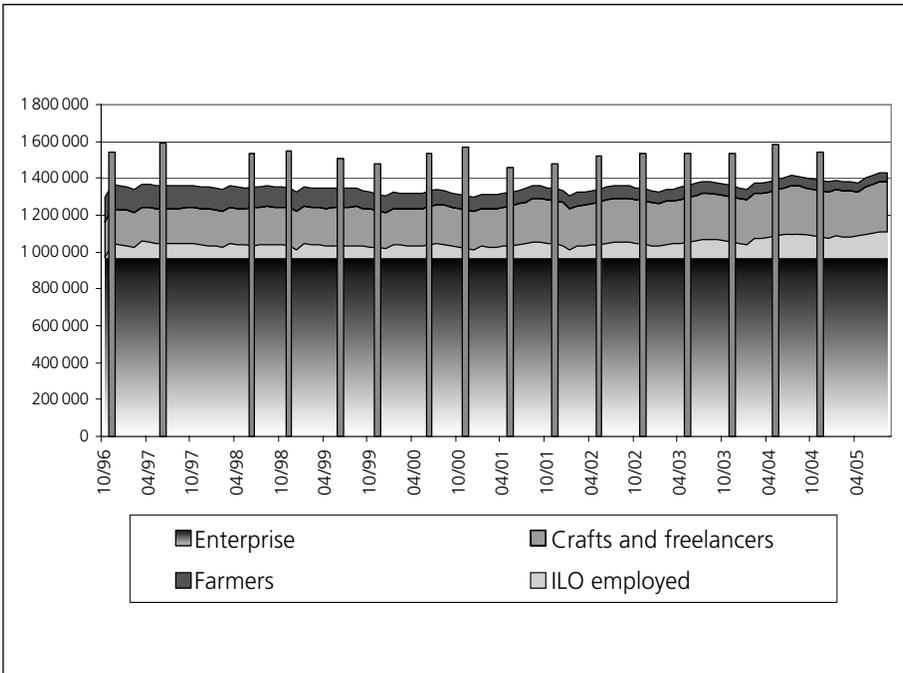
Activity rates in Croatia were low and they still remain low by European standards. In the 1970s the activity rate was 54%, in the 1980s it was 46%, and in the 1990s it was down to 45%. These figures understate the actual rate due to problems of measurement⁵ and the more representative rate from the LFS⁶ in 2002 was 50.9%.

The employment rate is also relatively low at 43.4% (50.7% for men and 37.1% for women) but slowly increasing.

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3. Croatia had a long-term mismatch between labour demand and supply which was evident in the relatively low participation rates. This means that a potential workforce was inactive due to a slack demand for labour and tended to become active in periods of stronger job creation. Such increases in the workforce were evident both in the growth of employment and of open unemployment which explains why these two groups tend to show simultaneous increases.
 4. One of the causes of the aggression in the former Yugoslavia was the weakening economic position of the two republics which had contributed most to the GDP of the country, namely Slovenia and Croatia. Most of the other countries were net recipients of transfers through a system of support for the less developed republics and their position became increasingly volatile without this support.
 5. The coverage by official sources of statistics of all economic activities of the population was inadequate in the socialist period because it measured only employment in the socialist sector. When large firms started to go bankrupt their over-representation in the samples used showed a more drastic fall in employment than actually took place because there were no instruments in place to measure increases in employment in the sector of small and medium companies. These problems were gradually improved, but the labour force survey remains the only source which gives an indication of the actual scope of economic activity. However, even this source shows relatively low activity rates as workforce reserves remain high.
 6. LFS – Labour Force Survey.

If we look at employment trends over the transition period they tend to show very different, if not divergent, trends from the two sources as shown in Chart 2.

Chart 2 – Employment from establishment data and from the LFS (1996-2004)

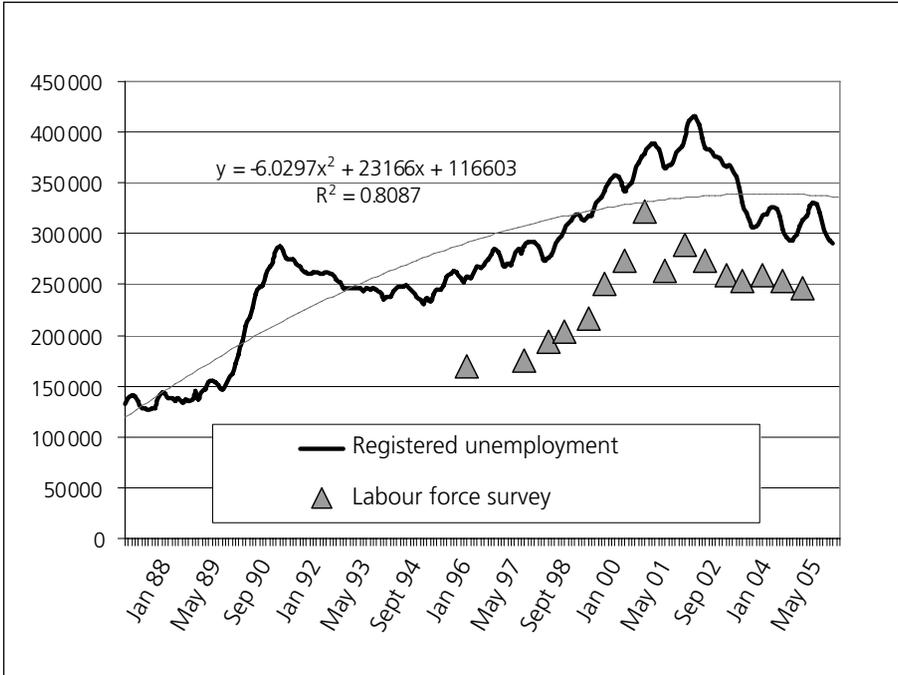


Source: LFS 1996-2002, Priopćenja, Croatian Bureau of Statistics.

LFS data show a consistently higher level of employment than establishment sources. The difference can be attributed partly to the fact that the latter cover only persons with labour contracts, farmers and craftsmen while the LFS covers all types of economic activity within the UN production boundary, which includes own-account workers, helping family members as well as working pensioners and the working "unemployed". On the other hand, the establishment sources, which depend on a monthly survey of all large companies and an under-represented number of small and medium companies overestimate job loss and underestimate job creation. Certain corrections were made to the sample recently, but the comparison with administrative sources (Croatian Bureau of Pension Insurance

and the Croatian Bureau of Health Insurance) shows a higher level of employment in the formal sector.⁷

Chart 3 – Unemployment from two sources (1988-2004)



Source: CES, LFS various years and CBS.

On the other hand, registered unemployment as published by the Croatian Employment Service (CES) and LFS unemployment are converging through time. Analyses of the LFS data, which also show persons who are registered as unemployed at the CES, point to the fact that the difference lies in

7. The two sources of administrative data also have their problems. For example, the Croatian Bureau of Pension Insurance has a certain number of insured who are on payrolls of companies in the previously occupied areas in eastern Slavonia but they had not worked since the beginning of the occupation. There are also persons who have the opportunity to pay for extended pension insurance although they are not employed. It is planned to bring in substantial adjustments and improvement of Bureau of Statistics establishment sources in the near future.

the possibility of staying registered while working on short-term contracts, in the shadow economy and in agriculture as a member of household. Up until the introduction of the new employment law there were no provisions for checking behaviour of the unemployed regarding job search and availability for work, which, together with absence of work, represent the international standard for definition of unemployment status.

The graph shows a time series of unemployment figures from the register of the CES and the LFS. The sharp increase in registered unemployment is very much reflected in the unemployment dynamics from the LFS but the level itself is consistently lower.

In the second half of 2002 there were 15 500 registered unemployed who were actually employed according to ILO criteria, which was 4.3% of the total; 49 400 or 13.7% were not looking for work; a further 8.2% were not available for work and 6.5% did not even want to work. On the other hand, there were 32 000 ILO unemployed who were not registered at the CES. The total difference between the two unemployment counts was 116 000.

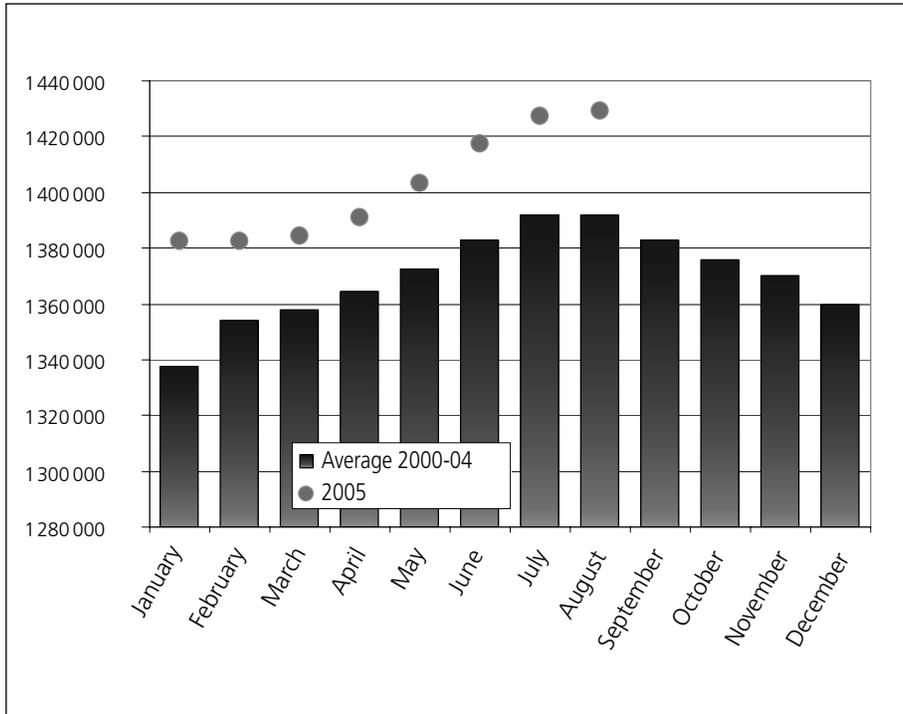
Since the introduction of the new law on mediation and benefits during unemployment, the CES monitors active job searches, availability for work and the incidence of employment. This practice has resulted in an increasing number of the registered unemployed being taken off the register mostly for reasons of having worked in the previous month.⁸

As we can see below, the tendency is for employment to increase substantially in the present year in relation to the six-year average.

This is a good sign, and it is mirrored in the increasing numbers of those who are employed on the unemployment register. Although outflows from the register have been greater than the inflows since the spring of 2002, the number of employed from the register has exceeded the number of new entrants only during the summer months when seasonal employment growth dominates. For a very long period in the past, separations on the register were split between employment and inactivity or informal sector employment, and the latter used to dominate when job creation was low in the formal sector.

8. CES exchanges data with Regos, and institutions responsible for monitoring the payments of contributions which are now levied both on labour contracts and short-term contracts equally.

Chart 4 – Average monthly employment (2000-04) and figures for 2005



Source: CBS and establishment sources.

The exits from the register, other than to employment, have recently been attributed to the implementation of the new law. Since its implementation, around 800 persons (0.2%) per month have been taken off the register either because of earnings higher than the maximum legal amount, due to failure to search for work actively or due to unavailability for work. In the summer months of 2003, this figure was up to more than 4 500, due mostly to short-term contract work in the tourist season.

One of the concerns linked to the implementation of the new legislation is that some of the labour market activities will start taking place outside the reach of the Croatian Employment Service. Since declaration of vacancies, which used to be mandatory for employers, became voluntary, there has been a dramatic drop in jobs available to the CES. This unprecedented decline is expected to recover but will require a major marketing effort and a higher quality of service towards the employers from the staff of the CES.

In conclusion, the transition labour market has some specific features which have to be taken into account when comparisons are made with developed countries. Informal sector employment provides a buffer for inadequate job creation in the formal sector but most income support, unemployment and social benefits are linked to formal unemployment status. This makes the de facto living standard higher than can be interpreted from official statistics. Actual employment is understated while unemployment is overstated, which has implications for the way corrective mechanisms need to be applied.

2.1. Labour market performance and employment stability and flexibility

The aim here is to describe the dominant types of employment relationships in the country according to their degree of flexibility and/or stability. The formal sector of employment is always covered by labour contracts that can be permanent or temporary. Today, more than 75% of all new labour contracts are temporary.⁹ In this way, the employers protect themselves against costs related to laying off persons with unlimited contracts, that is severance payments and procedures of proving violation of responsibility or inability to fulfil the requirements of the job. The law¹⁰ states that employees cannot continue working on a temporary contract for longer than three years and only on assignments that are by nature temporary. A person cannot be offered another temporary contract within a period of six months since their last similar contract.

Short-term contracts should only be resorted to if the nature of the job is a one-off activity that is not linked to the normal business processes. This type of contract is legal and, due to the new law on mandatory contributions, provides more social security for the worker since the employer has to pay the mandatory health and pension insurance. The only insurance that short-contract workers do not have is unemployment insurance. The reason behind not extending this type of protection is based on the belief that temporary workers would be facing a moral hazard and would intentionally resort to unemployment spells when they gather enough work time and become eligible for unemployment insurance. Of course, these contracts are also temporary and are not covered by any other rights under the Labour Law.

9. Source: CES, *Monthly Bulletin*, Table 2.

10. The Labour Law, Article 10.

Another type of contract is entered into with providers of intellectual services such as research analysts, consultancies, art and other authors' contributions. This type of contract is exempted from the law on mandatory contributions, mainly due to the strong lobbying by persons who use these types of contracts.¹¹

The fourth type of contract is a student's or pupil's contract, which is the cheapest legal type of contract. No income tax or contributions have to be paid under this type of contract. The only costs are those represented by mediation, which is payable to services in universities or secondary schools which have a franchise to mediate for this category on the labour market. Technically, only regular students are allowed to work but sometimes students waive their right in favour of non-students for a fee, but this is not a very widespread phenomenon.

All other types of work are practically illegal but quite substantial. The table below shows all the various activity and employment statuses of the employed in the second half of 2002.

Table 1 – Formal activity status of the employed in 2002 and 2004

	Total employment	Employed (employees, self-employed, farmers, helping family members, contract and own account workers)	Formally inactive (pensioners, students, housewives)	Unemployed (registered and unregistered unemployed)
2002	1 533 655	1 400 392	96 837	36 426
2004	1 542 437	1 431 669	72 433	17 084
2002 (%)	100	91.3	6.3	2.4
2004 (%)	100	92.8	4.7	1.1

Out of the 1.5 million ILO employed persons in 2002, 91.1% have declared themselves to be workers; 6.3% were pupils, students, housewives,

11. Most research institutions subsist partly on projects where the main means of payment are authors' contributions. The authors are, therefore, often employed and only pay personal income tax on their income. Self-employed authors such as painters or freelance newspapermen are often insured through their professional associations.

pensioners; 2.4% were unemployed and 0.3% were temporary and own-account workers, in other words at least 10% of the workforce do not feature in the employment statistics from establishment sources. They represent the legal but unregistered or illegal employment in Croatia. Adding the assisting family members and the short-term workers to the only formerly inactive and unemployed, there were in all 165 800 people working in the shadow economy. This has to be considered as only a smaller, measurable share of the actual informal sector. The 2004 status shows that the share of working pensioners and other inactive categories, as well as the formally unemployed, has decreased to below 6%.¹²

2.2. Wages and benefits

The degree of security for workers on the labour market can be measured by the types of rights and benefits that the employed enjoy. As shown in the table below, 77% of employees have received wages or salaries and the full package of insurance guaranteed under the labour law. This includes health insurance, pension insurance and unemployment insurance. The remaining 32.1% only had partial benefits, which means that they are missing any one of the above-mentioned insurances, or that they had not received any wages.

12. This calculation is possible due to a special questionnaire design in the labour force survey which applies the ILO standards for economic activity. First the employed are identified by international criteria and these persons are asked for a self-evaluation of their formal status. In this way many working pensioners, students, housewives and registered unemployed are found to be economically active. A further decomposition of the employed can yield an estimation of shadow economy employment.

Table 2 – The employed by remuneration and social benefits in 2002

	All employed persons	Employees total	Employees – Private sector	Employees – Public sector	Employees in mixed sectors	Self-employed and helping family members	Short-term contract and own-account workers
Total employment	1 533 657	1 179 497	611 337	535 063	33 098	313 206	40 953
Wages and full insurance	1 180 319	1 052 516	538 298	485 120	29 098	125 720	2 082
Work with partial benefits	492 227	126 981	73 039	49 942	3 999	187 486	38 871
% full benefit	77.0	89.2	88.1	90.7	87.9	40.1	5
% partial benefit	32.1	10.8	11.9	9.3	12.1	59.9	95

Source: LFS, CBS and LFS 2002/2.

The degree of security in the public sector is greater than in the private sector (90.7% coverage by full benefits and 88.1%, respectively) but the share of stable returns for work is lowest for persons working on short-term contracts, as own-account workers (5% coverage) and the self-employed (40% coverage). Since health insurance is a constitutional right of citizens in Croatia, the coverage by this type of insurance is not assured only through the work relationship but can be obtained through other types of status. Although some interviewees declared that they had no health insurance through work it does not necessarily mean that they are without it.¹³ On the other hand, pension insurance is designed with a strong bias toward the full-time job relationship and all other forms of part-time work are recalculated to the full-time equivalents. The result is that persons working part time have to have longer years of service, regardless of the amount they pay, in order to receive a full pension. This is a systemic inflexibility that has been rectified in line with the more flexible legislation on mandatory contributions for work that is not full time and permanent. Until these amendments became operational, there was a clear bias in the system against atypical types of work in the social insurance system.

2.3. Contracts without limit of time, fixed-term and short-term contracts

Another element of security on the labour market is the types of contracts as defined by duration that are offered to workers. The table below shows the four usual types of contracts that could be found on the Croatian labour market in 1997 and 2002. A very high share of contracts without limit of time in the economy indicates that the degree of security in the work relationship is still high, as in most other European countries. The 88.3% share of contracts without limit of time in 1997 has decreased very slightly to 87.5% over the last five-year period but the share of fixed-term contracts has increased from 6.7% to 9.7%. This indicates a tendency which has been fuelled by the practice of employers to employ new personnel on fixed-term contracts.

13. Health insurance is a constitutional right and one can become insured through a working family member or through the local authorities if there are no working family members.

Table 3 – Types of contracts by duration 1997, 2002 and 2004

	2004/2	%	2002/2	%	1997	%
Contracts without limit of time	1 071 707	87.6	1 092 040	87.5	1 147 803	88.3
Fixed-term contracts	125 498	10.3	121 161	9.7	87 416	6.7
Seasonal contracts (also fixed term)	15 582	1.3	16 034	1.3	25 948	2.0
Short-term contracts	10 170	0.8	18 905	1.5	38 107	2.9
Total*	1 222 957	100	1 248 140	100	1 299 274	100

* Only employees and helping family members are included.

Source: LFS 1997, 2002/2, 2004/2, CBS and author's calculations.

Table 4 – Duration of fixed-term contracts

	1997	%	2002/2	%	2004/2	%
Fixed-term contracts	151 471	100	155 242	100	151 250	100
Duration of contract						
Less than 1 month	4 402	2.9	4 851	3.1	3 118	2.1
1-5 months	30 678	20.3	80 046	51.6	81 762	54.2
6-12 months	31 773	21.0	24 406	15.7	26 305	17.4
Over 12 months	22 934	15.1	13 830	8.9	14 176	9.4
As required	61 685	40.7	32 109	20.7	23 713	15.7

Source: as above.

Until the mid-1990s, more than 50% of the contracts for new posts were permanent, which has now gone down to just above 20% with a tendency for this share to fall to just over 10% in the tourist season when most of the hiring is temporary. There is also a tendency for temporary contracts to increase their share in the employee group, as was the case particularly in 2004.

The duration of fixed-term contracts is also an interesting indicator of the stability of the work relationship. There has been an increase in fixed-term contracts as already shown above, but there is a parallel tendency for fixed-term contracts to be of a shorter duration.

In the table above, the number of one to five-month contracts has gone up from 30 600 in 1997 to 82 000 in 2004, which increased their share in total fixed-term contracts from 20.3% to 54.2%. At the same time both the six to twelve-month contracts and the longer-term contracts have reduced their share so that in 2004 only 9.4% of the contracts had a duration of more than twelve months. There has also been a steep reduction in the so-called open-ended contracts whose duration depended on the requirements of the job, from 40.7% to 15.7%.

This indicates an increasing number of temporary jobs on the market but also a worsening position of workers who compete for the jobs. A higher turnover of workers is also apparent on the unemployment register as they register several times a year between short, temporary jobs usually on fixed-term contracts. The law on mediation and benefits has recognised this tendency and has made access to benefits easier for persons who predominantly work on fixed-term contracts. Previously they had to work for at least twelve months over a period of twenty-four months if they wanted to claim benefits, and now they need to work for nine months and it is irrelevant over which period they attain the required number of months of work.

Short-term contract workers are in a worse position than persons with normal fixed-term contracts because they have no unemployment insurance and can therefore never claim unemployment benefits even though they have access to pension and health insurance.

2.4. Job tenure – Duration of employment with the same employer

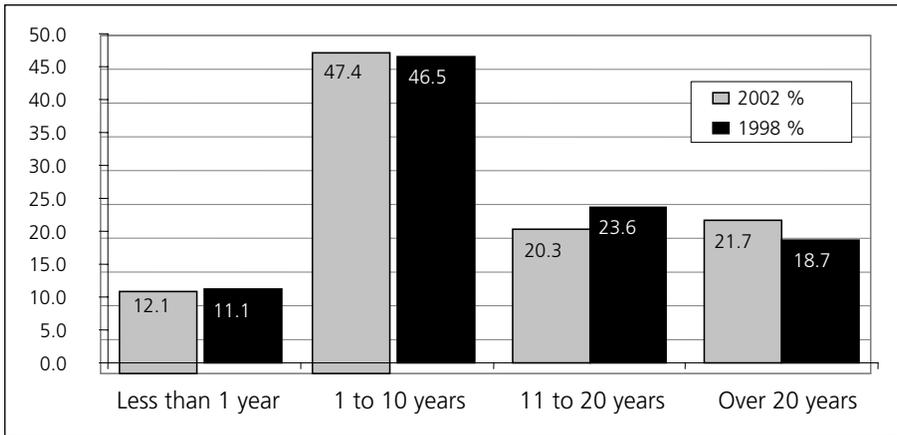
The permanence of contracts, although an indication of intent by the employer at the beginning of the work relationship, is no safeguard against lay-offs. Most of the 800 000 and more workers who lost their jobs during

the transition had, without exception, unlimited contracts. It is therefore important to look at the duration of employment with the same employer to see the actual tendencies that are very much linked to the state of the economy and other factors that influence business activity. Each company has its core workforce: those workers who are guarantors of a stable production capacity. Other workers are more or less permanent.

Of those in employment in 2002, 65% had found their present job since the beginning of the 1990s. A further 16.7% had been employed since the 1980s, which together makes more than 88% of the employed labour force. The remaining 11.7% of the workforce has been in employment for longer than twenty-five years.

In order to see the main tendencies in the duration of employment, the chart below shows employment duration of employees in 1998 and 2002. Almost half of the employees have been with their present employer for less than ten years and their share is increasing slightly.

Chart 5 – Duration of employment (2002)



Source: LFS 1998 and 2002/2, CBS and author’s calculations.

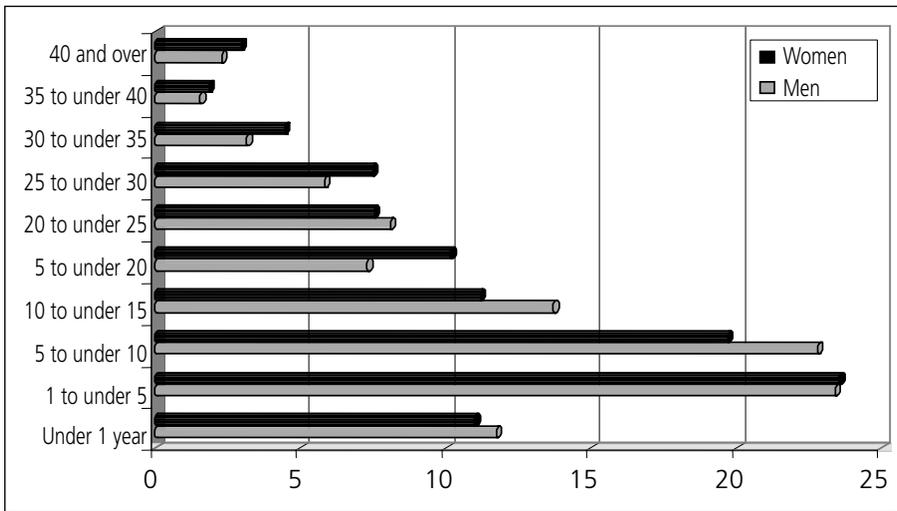
The share of employees with eleven to twenty years of service decreased in this period from 23.6% to 20.3%. Tendencies in the opposite direction are in the categories of workers at both ends of the spectrum; the share of those with less than a year and those with more than twenty years of service is increasing. Since the age structure of the workers coming to the register from firms in restructuring indicates that older workers dominate (31% of the registered unemployed in December 2003 were older than 45), the

rising share of persons with more than twenty years of service is possibly a demographic phenomenon in that workers from the baby boom generations have been in employment for longer than twenty years.

2.5. Job tenure and gender

Generally speaking there is no great distinction between men and women regarding the duration of employment. The share of men in employment of shorter duration is higher than women’s share and the opposite is true for jobs of longer duration where the share of women is slightly higher.

Chart 6 – Duration of employment by gender



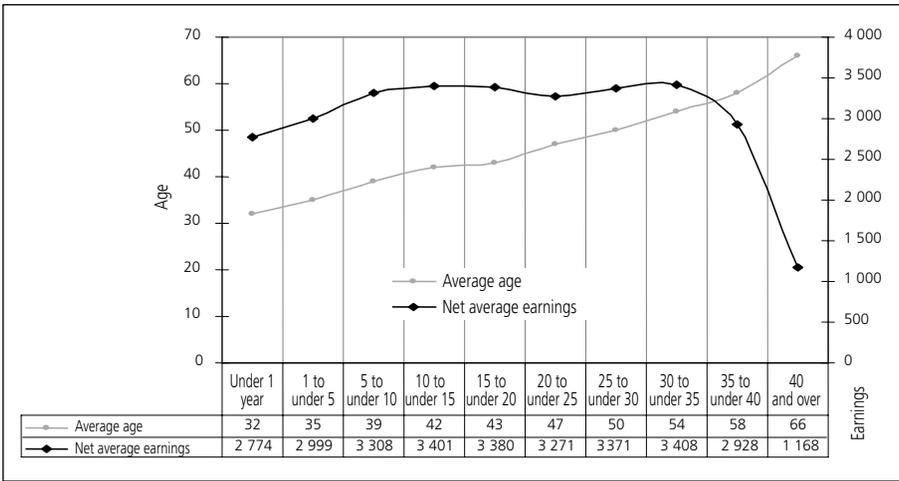
Source: LFS 2002/2, CSB 2003 and author’s calculations.

When this information is linked to the characteristics of unemployment by gender we see that men were more prone to the risk of unemployment at the beginning of the transition and during the war. After the mid-1990s, however, the traditional female domination in unemployment reasserted itself and women now dominate on the register. In addition, they wait longer for a job, especially older women.

Well over half of both employed men (57.9%) and women (54.2%) have found their present job since the beginning of the transition. If we include the five years prior to transition we can see that 71.7% of the male and 65.4% of female employment began within the last fifteen years.

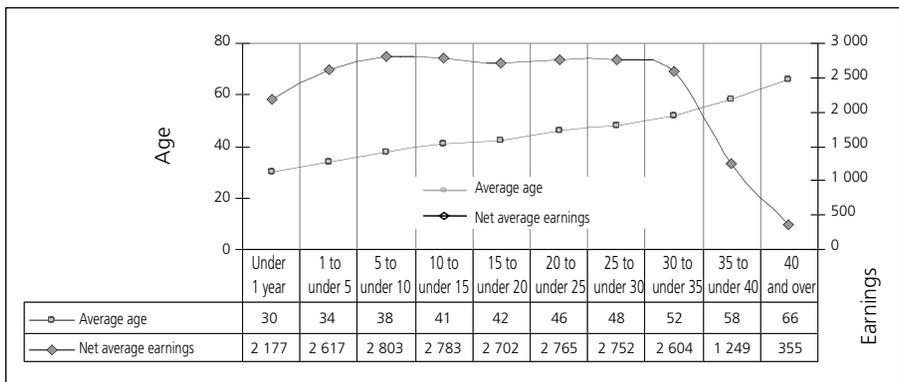
Some additional insights into gender issues concerning employment can be seen in the charts below where duration of employment is linked to average age and earnings for men and women.

Chart 7 – Men by age, earnings and duration of employment



Source: LFS 2002/2 and CBS.

Chart 8 – Women by age, earnings and duration of employment



Source: LFS 2002/2 and CBS.

The charts show the following gender differences concerning the relationship between age, earnings and employment duration:

- men, on average, earn more than women at all ages and employment duration levels;
- there is a steep increase in earnings with age and job tenure until the early 40s for men and late 30s for women;
- at the point of ten years of service, there is a slight decline in earnings with age and job tenure which is more rapid for women than it is for men;
- in the mid-50s and a job tenure of between thirty and thirty-five years there is a steep decrease in earnings which is much more rapid for women than for men;
- employees above the age of 60 have very low earnings but they are three times lower for women than for men.

The average age of the employed, both male and female, is rather high at 47 and 45 years of age, respectively. Even the employees with less than a year of service have an average age of around 30, which depicts the difficulties the young are facing when entering the labour market.

This analysis has shown that gender differences are considerable on the labour market as far as net earnings are concerned even though it has not been shown that the differences in job tenure are that large.

2.6. Multiple-job holding

A comparison of average earnings per month and the relatively high costs of living in Croatia indicates that some workers and indeed many other groups of the working-age population such as the registered unemployed have to work in order to make ends meet. The first table shows the incidence of multiple-job holding in 1998 and 2002 by employment status, hours of work and regularity.

Table 5 – Characteristics of multiple-job holding

		1998		2002
Total employment	1 549 237	100	1 533 657	100
Multiple-job holders	72 008	4.6	44 807	2.9

Regularity		%		%
Regular multiple-job holders	33 909	47.1	22 289	49.7
Seasonal	14 204	19.7	9 265	20.7
Occasional	23 895	33.2	13 254	29.6
Hours of work		%		%
1 to 10	31 830	44.2	16 929	38.0
11 to 20	23 659	32.9	18 639	41.8
20 +	16 519	22.9	8 984	20.2
Employment status		%		%
Employee in public sector	38 523	53.5	19 111	42.7
Employee in the private sector	21 159	29.4	19 552	43.6
Employee in the mixed sector of ownership	4 639	6.4	1 210	2.7
Farmer	3 369	4.7	1 682	3.8
Helping family member	1 688	2.3	716	1.6
Craftsman	1 359	1.9	941	2.1
Owner of enterprise	1 039	1.4	631	1.4
Own account worker	232	0.3	238	0.5
Freelance work		0.0	188	0.4

Source: LFS 1998, 2002/2, CBS and author's calculations.

There is a clear decrease in multiple-job holding since 1998 from 4.6% to 2.9% of the employed, but the regular characteristics have not changed significantly, with about one half of such workers having regular additional jobs, one third working occasionally and about 20% working seasonally.

In terms of hours of work, the duration of additional work has increased so that in 2002 most workers worked from eleven to twenty hours while the share of those working one to ten hours has declined.

The structure of multiple-job holders according to employment status shows that those who already have an above-average, stable job and

regular earnings also have the highest share among multiple-job holders, namely public-sector employees with 42.7% and private-sector employees with a 43.6% share. The obvious reason is that employees have more or less fixed working hours, which makes it possible to allocate free time to additional economic activities. However, those categories that may be in greater need of additional earnings are already putting in more than the average working hours into their main jobs and little time remains for additional sources of income.

2.7. Summary

The flexibility characteristics of the labour force have been looked at by considering five different indicators. First, the structure of the employed was looked at in terms of formal and informal employment status. About 6-10% of the employed were not supposed to be working, being either pensioners, shadow workers, unemployed, etc. The second indicator concerned wages and benefits by employment status and 32% of all employed had partial benefits or had not had wages paid in the reference period. Typically those employed in the informal sector were in a worse position and among them workers on short-term contracts and the self-employed had the highest percentages of partial benefits.

The third indicator relates to the types of contract entered into on the labour market. Although the current employees predominantly held contracts without time limits, only 15-20% of the new entrants on the labour market managed to acquire such a contract while others held either fixed-term contracts or short-term contracts. If this trend continues, the share of the employees holding contracts without limit of time will rapidly decrease. The reason why the share of these contracts has decreased very little from 1997 is the fact that although many fixed-term jobs are created over the year, especially during the summer season, most of these jobs disappear again and these changes cancel one another out when yearly averages are looked at. It is likely that the tightening of the labour law provisions on fixed-term contracts may make it more difficult for employers to use this type of contract for permanent types of jobs, which may reduce the use of fixed-term contracts.

The fourth indicator was job tenure with the present employer and this particular job characteristic was looked at by age, gender and sector of ownership, namely status in employment. The findings point to a situation in which 65% of the employed had found their present employment since the beginning of the transition. However, the average age of

the working population is above 40 for both men and women, indicating that the young are at a decisive disadvantage at the entrance to the labour market. Gender issues do not seem to be very important in the duration of employment and women seem to dominate among those with longer tenures. However, women earn less at all tenure levels and years of service. In particular, older women have very low incomes that are three times lower than for men. The duration of employment by sector indicates that the longest tenures are in farming and among helping family members while the shortest are among short-term contract workers and private-sector employees.

Multiple-job holding as an indicator of the need to supplement income from the main job in order to earn enough for sustenance has shown that this activity is on the decline and that the persons who take part are predominantly those who already have above-average jobs either in the private or the public sectors, and not necessarily in the informal economy.

In summary, the basic hypothesis is that more flexible types of work, which are typically characterised by frequent changes of job, partial benefits and inadequate social security and shorter job tenure, sometimes occur in the formal sector, especially in the private formal sector, but are much more characteristic of the informal sector of the economy. These findings confirm the hypothesis that the two segments of the labour market have very different work characteristics and that one is much more precarious than the other.

3. Labour market flexibility vs income-security issues

One important feature of a flexible labour market is a well-interlinked system of employment and social protection. If employment protection is reduced, this loss of security must be replaced by similar levels of security in the social security area. In the welfare-state system there was across the board a high level of social protection, mostly of the passive kind. There was an income support system that ensured a high level of wage replacement as well as a system of active labour market measures, which increased the chances of redeployment for some groups. Although most systems had a certain amount of targeting for employment protection as well as passive measures and active labour market policy, these legal provisions were not considered part and parcel of one system. For example, employment protection is ensured through the labour code while the active labour market policies are part of the employment code and all other aspects of protection are parts of other specific types of legislation in the area of insurance.

Although care is taken that no one falls out of the social welfare net by interlinking ages across legislation, social policy has rarely succeeded in streamlining legislation dealing with the labour market efficiently. What has changed since then in the thinking and practice in this area is that individuals are expected to take responsibility for their own lives, that the drive for competitiveness needs to take major responsibility for social security off the shoulders of the firms if we want them to open new workplaces and that the role of government has to take over some of the costs of labour market restructuring from the employers. Therefore, access to benefits becomes contingent on individual behaviour, labour market policy becomes much better targeted at those groups who are in danger of becoming long-term unemployed and the costs of severance payments and lay-off periods have partly been taken over by the government and transferred to recipients as upgrades in their unemployment benefits and their duration. However, if access to benefits is not equal for everyone, the whole mechanism will be inefficient and would not yield the required trade-off effects.

4. Policy recommendations: addressing the challenge

In a global market, firms find themselves in more turbulent competitive conditions and their survival has become more uncertain. Adjust or die is the creed today and this has resulted in the pressure for more flexibility on the labour market – the shouldering of insecurity is being diverted from the firms to the workers. Not surprisingly, in a world where the tradition of workers' rights has deep roots (both in the socialist and the capitalist European economies), there is huge opposition to this process. The question is: can the workers be protected when their firms are exposed to competition? National legislatures, workers' organisations and both international and national human rights organisations have defined very high standards for individual rights both in life and in work. How can these laudable goals be achieved in a national and a European setting? The worst effect of globalisation is the deepening of the rift between the skilled, who have learning opportunities in and outside work especially in technologically developed sectors, and those without skills and little opportunity for acquiring them.

Competitiveness today depends mostly on the quality of the labour input, its innovativeness, ingenuity and joint vision. On the other hand, community development, both economic and social, is a prerequisite for sustainable economic growth. The high social costs of fast growth without raising the quality of life for the majority can create barriers for further growth. In such a complex setting, can the drive for flexibility be the answer?

In transition countries job security had been total and they are an example of how a lack of competition and “security” which goes with it can lead to stagnation. However, these countries have a high level of flexibility in their shadow economies and yet there is very little evidence that the informal sectors have a level of performance which outstrips that in the formal sector by any means. It is usually the economic activity which workers resort to in absence of a better solution in the formal sector, with lower productivity levels.

The labour market segmentation that arises from these differences in the working environment in transition countries requires policy options which aim to decrease the existing segmentation. This may mean that the labour legislation in the formal sector needs deregulating and that efforts have to be made to improve, in other words legitimise and/or squeeze out the informal sector economic activities. This has to be done in such a way that all types of work ensure equal levels of social security and that can only be done if interventions are made in the tax system, labour legislation and the social security arrangements. Employers and their behaviour under conditions of abundant labour is such that many workers lack basic insurance, wages are not guaranteed and decent remuneration for work is often absent. Once labour legislation puts all types of work on an equal footing, labour inspectorates need to be more widely present with power of authority to close establishments that employ people without registering them for the mandatory social insurances. The dichotomy between permanent and fixed-term contracts should be withdrawn and all contracts be made permanent, but the ease with which they can be terminated and the costs associated therewith should be further reduced.

Social protection for the unemployed should make it possible for them to survive on unemployment benefits rather than resort to unofficial work.

Croatia has made very important changes in the legislation that works towards equalising the positions of all who work. Issues of social security have also been solved in this way as all persons working on short-term contracts who could not previously have access to social security now have this privilege.

There are still some weaknesses in the segment of the legal protection of workers, large arrears in work-related court suits, a weak labour inspectorate and weak trade union activity in the private sector and in the secondary market. Certain advancements have been achieved in the new law, which regulates workers’ arrears prior to bankruptcies, and it is clear that more pressure on employers will have to be applied in order to get more

efficient protection of workers' rights. At the same time, lay-off periods, severance payments and other costs of mobility need to be traded off for longer, and in time higher, unemployment benefits. If the benefit is not high enough to cover simple costs of living, the informal markets will have to supply the difference and this will feed the shadow economy. In this vicious circle, the break must come if and when the point is reached where more jobs are being created and employment becomes a realistic opportunity for the unemployed. There is no third way.

A further question, which needs to be looked at in terms of policy recommendations, is the link between employability, security and income. Today, security can no longer be linked to preservation of existing jobs no matter what. Mobility is good for development and it should be promoted especially in periods of rapid structural change. The main source of stability as well as income potential stems from employability rather than protection through a rigid legal framework, trade unions and worker-oriented labour courts. It is still rather unclear to some that preventing adaptation of firms to new circumstances even by reducing the workforce is not something that firms do because they are habitual law breakers, but rather they try to adapt in the short term in order to maintain the company's viability.

The role of ALMPs in job security

Policies that should facilitate restructuring in flexible labour markets should include the following provisions:

- mobility or redeployment centres for pending large redundancies whose aim is to put back into work workers who will lose their jobs;
- identify the unemployed who belong to categories of potential long-term unemployment and help them regain competencies which are in demand on the labour market;
- place very high importance on the activation principle which requires more individualised or group-oriented services in the public employment service;
- introduce the workfare principles for persons who use the social welfare system so that they receive training during their community-based work;
- develop public-private partnerships which will facilitate networking of all stakeholders in the area of employment, development and education;
- introduce effective mechanisms for giving support to the job-seeker in his or her job search and career guidance.

Roles of individuals, companies, social partners, labour market institutions and the state in a changing labour market

Individuals

The role of the individual in seeking and finding work has become much greater now that information sources have become open to all those who care to look. State paternalism is over and individual responsibility for one's life has become the norm, especially among the unfortunate who are out of work.

Companies

In the business world today a paradigm shift is becoming visible. Corruption and cut-throat competition have characterised the biggest firms and questions of ethics are beginning to be asked once again. People are becoming a key competitive advantage and this trend will slowly push out those companies that are not capable of mobilising motivated, capable and creative employees. As such, they will be in a good position on the labour market if and when they give up their present jobs.

Social partners

The present role of the trade unions is to slow down or stop the process of reform on the labour market. This needs to change in view of the need to provide equal standards of protection for all workers and not just some of them. The real challenge is how to provide protection for the shadow economy worker rather than how to further increase the level of protection for the already highly protected public-sector workers. The second biggest challenge is to focus on training as an obligation of the employer and introduce this element into labour legislation as well as in the delivery of support and services to employees.

Labour market institutions

Both public and private institutions such as job agencies and the public employment service need to work together to increase the accessibility of information. Further, the public employment service must build competencies for early identification of potentially excluded categories and co-operate more closely with the social welfare system, the non-governmental organisations and all those who have an interest in the same target population. More involvement in development initiatives on the one

hand and community work arrangements on the other is the expected orientation for public employment services in the future.

The state

The role of the state should be reduced to macroeconomic policies that will provide a stable and predictable environment with as few bureaucratic ways of providing services to citizens, companies and other organisations as possible. The fiscal system must promote the value of work and it should have the widest possible base. Support to start ups and a conducive entrepreneurial environment are essential. However, the biggest obligation of the state is to invest in a good education system as well as to support scientific research. A crucial feature is an up-to-date adult education system that is capable of providing skills needed on the labour market. Also, a sophisticated system of data collection from the sector of businesses, educational establishments, employment services and the government needs to be set up in such a way that a good information system for the labour market starts developing.

Worker security based on adherence to existing jobs at all costs is a stance which will create problems in achieving global competitiveness in a small, open economy. The key to security on the labour market is though training, personal development and activation.

II – Flexicurity specificities in small and open transition economies – The Baltic states

Raul Eamets, Professor of Economics, University of Tartu (Estonia)

Introduction

The eastern enlargement of the European Union and the requirements of the European Monetary Union (EMU) have increased pressure for flexibility of labour markets both in the current European Union member states (EU-15) and accession countries. In the framework of the EMU, and in order to follow the requirements of the optimal currency area (OCA), the growth of labour market flexibility is desirable because it helps to offset asymmetric shocks, especially when other means such as monetary and fiscal policies are constrained. If labour markets and institutions do not become more flexible, the growth of market disequilibrium is highly probable in both groups.

In other words, flexibility has a broader economic policy importance as well. All three Baltic states are known for their strict monetary and fiscal policy. The currency board system in Lithuania and Estonia means that the functions of central banks are very limited; annually balanced budgets mean that government tools of fiscal policy are limited as well. In such an economic situation, one should have a buffer in the case of macroeconomic shocks (such as oil price increases on the world market). This buffer is a flexible labour market which will react relatively quickly to a changing macroeconomic environment.

These countries have a serious dilemma: how to keep a high economic growth rate, which is needed to catch up economically; how to keep liberal economic policies with the policy restrictions described above; and how to maintain flexible labour markets when high flexibility means less social security or in a broader sense less social cohesion.

We can say that European (both old and new member states) labour markets will face serious challenges in the near future. On the one hand, there are high expectations connected with the competitiveness of the European economy, which also means more flexible labour markets. On the other hand, the European social model has stressed high labour security and social cohesion. When we put these two developments together we get a relatively new concept called labour flexicurity. Wilthagen and Rogowski (2002: 250) have defined it as “a policy strategy that attempts,

synchronously and in deliberate way, to enhance the flexibility of labour markets... and to enhance security – employment security and social security – notably for weaker groups in and outside the labour market”.

This is a new concept for the EU as well, and it is not widely accepted in all member states. We believe that one advantage of the Baltic states’ economies is the still flexible labour markets. Social protection is not as well recognised, partly also because trade unions are not influential. However, we believe that this situation will change as more and more employees understand the need for better social protection. Today it is a relatively new and unknown issue.

In countries with a well-developed social dialogue, social partners participate in the negotiations of labour laws, so we would expect the laws to be more favourable for employees where there are powerful trade unions. However, in the central and eastern European countries, employment protection laws are not only relevant for the protection of employees, who are vulnerable partners in employment relationships, but also because trade unions are rather weak and often absent in many companies.

The aim of this paper is to analyse dilemmas of flexicurity from the point of view of the new EU member states. We will use examples from all three Baltic states and particularly from Estonia, which can be considered a textbook example of very liberal economic policy and successful economic reforms. Also we will present comparable information from other central and eastern European countries and average figures of the EU. We describe different aspects of labour market flexibility, job security and recent labour market and welfare-state reforms in Baltic states. We observe the effects of the transformation on labour flexibility and particularly on job security and social cohesion. More specifically: What are the current mechanisms of adjustment of the labour markets? To which degree is labour flexibility a condition to improve the competitiveness of the Baltic countries? We conclude with recommendations for policy actions.

1. Theoretical considerations of flexibility and security

Four different aspects of labour market flexibility are usually treated (OECD, 1999):

- External numerical flexibility is the employer’s ability to adjust the number of employees to current needs. In other words, it is the ease of hiring and firing workers, which manifests itself in the mobility of workers between employers (external job turnover).

- Internal numerical flexibility is the employer's ability to modify the number and distribution of working hours with no change in the number of employees.
- Functional flexibility is the employer's ability to move employees from one task or department to another, or to change the content of their work. It reflects the mobility of employees within companies (internal labour turnover).
- Wage flexibility enables employers to alter wages in response to changing labour market and competitive conditions.

In addition to the above-mentioned flexibility aspects, externalisation flexibility is also mentioned in literature (Keller and Seifert, 2004; Vielle and Walthery, 2003). This is the employer's ability to order work from external workers or firms without employment contracts but with commercial contracts (for example, distance working, teleworking, virtual organisations, etc.).

The shortcomings of such an approach come from the underestimation (or potential misinterpretation) of the role of institutions. One can say that numerical flexibility reflects directly the influence of institutions, labour protection and labour market policy issues. However, this is not always so. For example, we can say that employment protection in the Baltic states is well developed – in all the Baltic states the EPL (Employment Protection Legislation) index is close to the EU average. But if we compare changes in the labour market, then in the Baltic states we can observe very rapid restructuring and high labour turnover, which is not the case in the old EU member states. One explanation for this could be that while labour laws exist, they are not followed very strictly (see also the discussion in section 3).

In our analysis we will stress those institutional aspects more, because individuals are directly influenced by labour and social policies implemented by governments. Social security systems, indeed, are one of the most powerful institutional expressions of social solidarity and social cohesion.

In this paper we use a relatively novel approach to labour market flexibility. We argue that labour market flexibility should be measured at two distinct levels: macro- and micro-level (see also Eamets et al., 2003).

Macro-level flexibility can be further divided into institutional and wage flexibility. The institutional flexibility of labour markets denotes to what extent state institutions and trade unions are involved in the regulation of the labour market. It could be measured by different indicators, but one of the most common is the EPL index. Trade union influence is measured by

collective bargaining coverage rates and union density rates. State involvement in labour-market interactions is measured by the share of labour policy expenditures of the GDP (very often the share of active labour market expenditures of GDP is presented separately). Wage flexibility shows how responsive wages are to market fluctuations and there are different indices measuring wage elasticity to employment changes.

Micro-level flexibility is related to three types of labour market mobility: workers mobility, jobs mobility and workplace mobility. Workers flows indicate labour flows between different labour market conditions (unemployment, employment and inactivity). However, geographical mobility of labour and occupational mobility is part of the picture. Geographical mobility could mean domestic or internal mobility or international mobility. Occupational mobility shows how many people move between different occupations. It can be either flows inside the firm (treated as functional mobility) or flows between firms.¹ Job mobility could be characterised by job creation and destruction, in other words how many jobs are opened or closed during a certain period of time. The third aspect of micro-level flexibility is connected to workplace mobility. This covers working-time flexibility, which reflects possibilities to do overtime work, part-time work, shift work, etc. Also it covers how many different flexible workplace arrangements (teleworking, temporary agency work, hot-desk principle, etc.) are used.

Security also includes several issues. Wilthagen, Tros and van Lieshout (2003) restrict consideration to the following types of security:

- Job security, which is the main subject of the employment protection legislation and is guaranteed by the protection of employees against dismissals and against significant changes in working conditions.
- Employment/employability security denotes the certainty of remaining at work. It means the availability of jobs for dismissed and unemployed workers, corresponding to their qualification and previous working conditions. The employability of job-seekers can be improved for example by lifelong learning, training programmes within active labour market policies, etc.

1. High occupational mobility shows a high level of human capital and/or well-developed training and lifelong learning opportunities, which makes the occupational changes relatively simple for workers. However, it can also show rapid structural changes in the economy caused by external shocks, such as the transition shock in central and eastern European countries. A huge number of workers were forced to change their occupations as their previous jobs just disappeared.

- Income security means the protection of income through minimum wage determination, wage indexation, social policy and taxation, etc.
- Combination security is the certainty of being able to combine paid work with other social responsibilities and obligations (for example, work-life balance, flexible working hours, leave facilities, etc.).

One of the most relevant aspects of the multidimensional concept of labour flexibility is social protection regulation. The “institutionalist” view of employees emphasises that labour regulations are needed to circumvent the weak bargaining power of employees in employment relationships, that there is inadequate insurance against the risk of unemployment as well as the need to moderate effects of downsizings in aggregate demand and to enhance investments in human capital and thus productivity growth. The “distortionist” view of employment protection regulation emphasises the advantage of market processes and argues that strict employment protection legislation increases dualism of the labour market by favouring insiders (regular workers), increases effective labour costs, discourages hiring and impedes adjustment to economic shocks. Therefore, in order to avoid adverse labour market outcomes, some trade-offs have to be made between employment security and labour market flexibility.

2. Economic background

2.1. Macroeconomic background

In 1989, the Baltic economies were part of the economy of the Soviet Union and were closely bound up with the raw material and product markets of the former Soviet Union. Thus at the beginning of the transition period, the employment structure in all three Baltic states reflected the rather artificially shaped structure of the proceeding economy from the economic needs of the Soviet Union. The years since 1989 have been a period of deep changes in all three economies. This period consists of different sub-periods. Between 1989 and 1991, these countries were still a part of the Soviet economy, but they had already started initial macro-economic reforms such as the liberalisation of prices. Drastic changes in the economy took place in the period 1991-93. In 1992-93 all three states introduced their own currencies. At the same time, principal decisions were made, in the Estonian case about complete freedom in foreign trade, and the requirement of a balanced state budget was written into the Estonian Constitution. This created a completely new environment for business activities and is considered as the beginning of economic reforms

in Estonia. As a result of the combination of macroeconomic reforms, the Estonian economy was reoriented toward western partners. The same happened in Latvia, but to a lesser extent in Lithuania. Both countries established certain trade barriers. The highest GDP growth rate in the Baltics was achieved in 1997. After a short recession period caused by the Russian financial crises in 1999, all three Baltic states achieved stable economic growth, with GDP growth about 6% to 8% per year.

2.2. General trends in the Baltic states' labour markets

Following the pattern of most other east European economies, the activity rate (labourforce participation rate) declined sharply in all three Baltic countries. We can say that there are some small variations in labour force participation and employment rates across gender and age groups. The rates overall, by gender and by age group, are quite similar across countries, but some trends are markedly different. The declining participation in Estonia and Latvia over these four years, whether measured with respect to the over-15 population or just for ages 15 to 64, holds roughly equally for both genders, while in Lithuania a falling male participation rate was largely offset by a rising female rate. By age, the biggest changes in participation tend to take place for the youngest and oldest groups.

The difference between the magnitude of the decline in activity and the employment decline is of course mirrored in the rise in unemployment.

The Baltic states have experienced some of the highest levels of unemployment in all of the east European economies, with maximum rates of 13.7% in Estonia (2000), 19.4% in Latvia (1996) and 17.1% in Lithuania (1995). By 2000, the rates were roughly equal in all three countries, in the 13% to 15% range and since 2001 there has been a gradual decline in unemployment in all three countries. In 2005 unemployment rates were around the EU-25 average of between 7% and 9%.

If we analyse the Baltic states, the serious employment losses have occurred in the industrial sector (Latvia and Lithuania) and in all three countries in agriculture. The most dramatic decline of agricultural employment took place in Estonia, where total employment dropped from 140 000 (1989) to nearly 30 000 in 2001. A decline in the range of 80% is a very serious one and as a result we can observe increasing long-term unemployment in many rural areas in Estonia.

3. Labour market regulations in the Baltic states

3.1. Private sector

Next we will have a closer look at the strictness of the labour market legislation in Estonia, Latvia and Lithuania by its effect on labour market flexibility. In the Baltic states, the regulation of employment relations mainly corresponds to international standards, as the more important ILO conventions are mostly ratified and the legislation assures the protection of employees' basic rights concerning work time, remuneration, holidays and termination of contracts, protection of employees in less favourable conditions, etc. However, the average number of ratified ILO conventions for the Baltic states (37) is well below the numbers that both central and eastern European and EU countries have signed (respectively 62 and 88; see also Table 1).

Table 1 – Labour legislation and unionisation in central and eastern European countries

Country	Number of ILO conventions ratified, 31.12.02	Year of adoption of relevant national law	Unionisation rate %*	Direct collective bargaining coverage %**
Latvia	45	Labour Code 1972; Labour Law 2002	30	< 20
Lithuania	34	Law on Employment Contract 1991; Labour Code 2003	15	10 to 15
Estonia	31	Employment Contracts Act 1992	< 15	29
Central and eastern European countries	62	–	25.8	45.2
EU-15	88	–	43.8	78
USA	14		13.5	15

Source: Carley, 2002.

* Percentage of salaried workers who belong to a union.

** Proportion of workers who have their pay and conditions set, at least to some extent, by collective agreements.

Concerning laws, most regulations are covered by special laws on employment relations (not the constitution) and labour relations are governed by employment contract (except for those working in the civil service).² On the one hand there are several similarities across Baltic states: laws prohibit differential treatment and there exist upper limits for regular working hours, overtime and night-time work. Workers are granted regular vacations and other leaves, termination of employment contracts is subject to restrictions, for example, the obligation to give advance notice, pay compensation, etc. In relation to the presence of such provisions, labour legislation in the Baltic states resembles those of the EU countries.

The notification period varies in Latvia from ten days (employee's misconduct) to one month (lay-offs). In Lithuania the period is two months (four months for minors, parents of children, etc.). In Estonia, the notification period varies from two weeks (long-term incapacity for work) to four months (lay-off of workers who have continuously worked for the employer for over ten years). The duration of the compensation varies in Latvia from one to four months, the average wage depends on the employee's work experience with the present employer (according to the Labour Code, valid until 1 June 2002, the compensation was no less than one month's average pay and the notification period was one month). In Lithuania, the compensation varies from one to twelve average monthly wages, depending on the reason of termination and the length of work record with the present employer. In Estonia, the compensation for termination varies from one to four months' average wage.

3.2. The status of civil servants

In the Baltic countries the status of civil servants is regulated by separate laws, therefore employment contracts shall not be concluded with civil servants (the Republic of Latvia State Civil Service Law (1 January 2001); the Public Service Act (1 January 1996); and the Republic of Lithuania Law on Public Service (8 June 1999)). So civil servants have some advantages, but are also subject to additional duties. The positions of civil servants are grouped into categories and civil servants are given grades (Lithuania, Estonia) or qualification categories (Latvia). Regarding civil service positions, there are

2. For details, see the Republic of Latvia Labour Law (www.ttc.lv/en/default-translations-lr.htm); the Republic of Lithuania Law on the Employment Contract (www3.lrs.lt/c-bin/eng/); and the Republic of Estonia Employment Contracts Act (<http://lex.andmevara.ee/estlex/>).

Table 2 – Advance notice periods and severance pay in the case of dismissals in the Baltic states

Length of record with the present employer	Estonia		Latvia		Lithuania	
	Notice Period	Severance pay	Notice Period	Severance pay	Notice Period	Severance pay
Up to 5 years	2 months	2 months' average pay	1 month	1 month's average pay	2 months	2 (4) months' average pay
5 to 10 years	3 months	3 months' average pay	1 month	2 months' average pay	2 months	3 (6) months' average pay
10 to 20 years	4 months	4 months' average pay	1 month	3 months' average pay	2 months	4 (8) months' average pay

Source: The Republic of Estonia Employment Contract Act; the Republic of Latvia Labour Law; and the Republic of Lithuania Law on the Employment Contract. Note: in Lithuania the higher severance pay (numbers in parentheses) is applied in cases of lay-offs other than liquidation of firms, reduction in production, etc.

several restrictions which, being similar across the countries, are related to citizenship, command of the official language, education and age.

Civil servants are paid salaries according to their grades, qualification categories and levels of position. They are granted annual leave of absence and other vacation and leaves. They are entitled to special benefits in case of death or work accident, have the right to get their training and improvement of professional qualifications financed by the state, municipal, or other budgets. For public servants there are special restrictions and duties such as limitations on their possibilities for part-time work elsewhere, political affiliations (Estonia), responsibility for lawfulness of their actions or failure to act (Latvia), etc. So we can conclude as a generalisation that the status of public servants is more regulated than the status of employees working under employment contracts.

3.3. *The overall EPL strictness*

The Baltic states have followed main international labour standards as well as adopted most of the EU directives on labour relations and the overall strictness of labour regulations is close to the EU level. However, there exist cross-country differences. Individual dismissals are less unconstrained in Latvia compared to Estonia and Lithuania; the value of the collective dismissals index for the Baltic states is higher than the average of the European Union (see for details Eamets and Masso (2005)). On the other hand, the use of temporary employment is less restricted in the Baltic states than in the EU, and in Latvia their use is less restricted than in Lithuania and Estonia. Among the group of central and eastern European countries the cross-country variation is greatest in this area. In all three Baltic countries, the regulation of collective dismissals is stricter than in the EU countries on average (that actually characterises the whole set of central and eastern European countries). Despite the differences in most of the detailed indicators, the overall EPL strictness does not seem to be very different across the Baltic states (in Latvia the regulation is possibly more favourable to employers).

In central and eastern European countries, generally, the overall EPL strictness is close to the average EU level, too – the value for the EU is 2.5 compared to the average of 2.4³ in nine central and eastern European

3. The calculations were made according to the method in *OECD 1999 Employment Outlook* as well as the method developed by Nicoletti et al. (2000). The calculation of the indices proceeds as follows. First, each of the detailed indicators is converted into a scale ranging from 0 to 6. Scaled indicators are weighted and added together to

countries (the three Baltic states, Poland, Hungary, Slovakia, the Czech Republic, Slovenia and Bulgaria). That is because in the 1990s, the transition countries established various forms of employment protection legislation similar to continental European countries and rejected Anglo-Saxon “hire at will” industrial relations,⁴ so that by the end of the 1990s, regulations broadly resemble those found in the EU countries (Riboud, Sanchez-Paramo and Silva-Jauregui, 2002).

From a formal point of view, the legal regulation of the labour market seems to be in place and the worker is even better protected in the Baltic states than in the EU. But in practice, it appears that state regulations are not always followed in the private sector and there is substantial evidence of violations of these regulations in companies in the Baltic states.

Table 3 – The enforcement of EPL in the Baltic states and EU countries

	Year	Complaints to inspection tribunals /employees (%)	% of cases won by workers	Strictness of unfair dismissal definitions, on a scale of 0 to 3
Latvia	2000	0.19	88	2
Lithuania	2000	0.22	68	1
Estonia	2000	0.54	65	2
Baltic States	2000	0.32	73	1.7
EU	1995	0.21	50	0.9
USA	1995	0.02	48	0

Source: Eamets and Masso, 2005; and Bertola, Boeri and Cazes, 1999. Tööinspektsioon (www.ti.ee), Lietuvos Respublikos Valstybinė darbo inspekcija (www.vdi.lt), and Latvian

second-level indicators. Concerning regular (unlimited) contracts, in the OECD 1999 method there are three second-level indicators, procedural requirements, notice and severance pay, and difficulty of dismissal. In the index of Nicoletti et al. (2000) information is aggregated into three factors: procedural inconveniences, direct firing costs and notice and probation period. For the first method, the index of overall strictness of regulation is a simple average of three second-level indices, for the second method, factors are weighted. The final measure varies from 0 to 6; a low value indicates flexible EPL and a high-value strict legislation.

4. One reason for such an option was presumably also the fact that trade unions lost their power quickly after economic reforms started. In order to protect workers, employment protection legislation was introduced.

State Labour Inspectorate (www.vdi.lt). OECD (1999): scored 0 – worker capability or redundancy of the job are adequate grounds for dismissal; 1 when social considerations, age or job tenure must, when possible, influence the choice of which worker(s) to dismiss; 2 when a transfer and/or retraining to adapt the worker to different work must be attempted prior to dismissal; and 3 when worker capability cannot be a ground for dismissal.

Bertola et al. (1999) have noticed that measuring the enforcement of EPL is difficult as statistical information is relatively scarce; it is seriously affected by selection bias and jurisprudence may be affected by the underlying labour market conditions, for example, they have become endogenous (that is court rules may become favourable to employees in case of heavy labour market conditions). Having these caveats in mind, we may infer from the information presented in Table 3 that in the Baltic states employees have been rather active in submitting complaints to labour inspectors, and they have won quite a high percentage of cases (compared with the average numbers of EU countries); still the latter may be induced by the frequent violations in the first place. The much lower number of cases in courts is because commissions are the first step in dispute resolution. Also limited court capacity may be the problem. For Latvia, it has been mentioned that labour dispute resolution with the assistance of labour dispute commissions or courts is not widespread. Although Bertola et al. (2002) found that countries where high numbers of cases in tribunals were associated with a high percentage of cases favourable to employees, we cannot see that when comparing the three Baltic states. The definition of unfair dismissal may both encourage workers to appeal and encourage employers to reach agreements before appeal, so it is hard to say whether that is behind the high rate of appeals in the Baltic states.

In conclusion, our finding is that concerning the scarce evidence on the enforcement of EPL, in the Baltic states compared to the EU the enforcement indicators are at a relatively higher level, which, however, is also due to the frequent violation of regulations. The problem is that appeals may constitute only a small number of all law violations. There are other reasons to believe that the number of unreported violations is even higher, for example in many cases so-called voluntary leaves are only reported as voluntary. There is evidence of so-called extra agreements (such a contract could be a notice of dismissal (voluntary leave) signed by the employee and left with the employer with an open date). In other words, the employee and employer could sign an extra agreement by which the employee resigns some of his/her benefits for the employers' advantage.

From the point of view of EPL strictness it is important which proportion of the workforce is actually covered by the regulations. In the Baltic states we found that the share of workers on unlimited contracts is close to the EU level, but temporary employment is more widespread (implying a higher level of flexibility).

4. Labour market policy and institutions in the Baltic states⁵

Compared to the EU, the Baltic states' labour market policies are rather insufficiently funded. In 2001, the expenditures on labour market policies accounted for 0.22% of the GDP in Estonia, 0.64% in Latvia and 0.27% in Lithuania. This is a very small fraction compared to the respective average rate of 2.48% in the EU or even the respective rates in selected EU candidate countries (see Table 4).

Also, the share of active measures is relatively low in both expenditures and participation rates. In Lithuania 34.1%, in Latvia 22% and in Estonia 28% of the overall employment policy budget is allocated to active measures, while the EU average is almost 40%. At the same time, the overall coverage of the unemployed by the system of income maintenance is still low in all three states.

Table 4 – Spending on labour market programmes in the EU and selected candidate countries in 2000

	Total spending (% of GDP)	Active spending (% of GDP)	Active spending (% of total spending)
Estonia	0.22	0.06	27
Latvia	0.76	0.15	20
Lithuania	0.27	0.09	33.1
Czech Republic	0.52	0.22	42.9
Hungary	0.87	0.39	45.3
Poland	2.25	0.54	24
EU	2.48	1.12	39.8

Sources: Martin et al., 2001, p. 7, Estonian Labour Market Board, Ministry of Social Security and Labour of the Republic of Lithuania, and "Joint assessment of employment policy priorities in Latvia".

5. A large part of this text is based on Paas et al. (2003)

4.1. Unemployment insurance

Replacement rates are likewise low in comparison with 60% of the EU member states. Slight differences among the Baltic states can be pointed out: the replacement rate is lower in Estonia and Latvia, and higher in Lithuania where it amounts to the EU average in certain cases. Still, it can be noted that in all three states the income maintenance systems have to a certain extent dampened people's incentives to look for a job. The influence is still minor in comparison with the well-developed European countries where the replacement rates are sufficiently large to have a significant effect on work incentives and consequently on labour market flexibility. However, given the political conditions, only marginal cuts have been made in the generosity of benefit entitlements. Rather the eligibility conditions to receive benefits are tightened and activation strategies for the unemployed are developed. The Baltic states have the same path ahead of them.

Currently, participation of registered job-seekers in active labour market measures is insufficient. In accordance with the European Union's employment guidelines, the goal is to achieve the involvement rate of 20% of the unemployed ("Joint assessment of employment policy priorities in Estonia", 2001). At the moment, the respective figure is highest in Estonia at 10%, followed by Latvia's 4% and Lithuania's 3%. It is not clear if recruitment to programmes is appropriately targeted. The groups covered are not necessarily those to which greatest priority should be given in the light of changing labour market circumstances. Apparently, there is a need for comprehensive analytical evidence on the effect of the existing programmes. Such essential knowledge would serve as a basis for developing well-targeted and successful programmes in the future.

4.2. Labour market legislation

Obviously, the labour market policies of the Baltic states need to be reformed both upon and after their EU accession. According to different EU evaluations, in Estonia one of the main problems is the poor targeting of programmes (See also "Joint assessment of employment policy priorities in Estonia", 2001). Given the limited resources available, it will be important to ensure that these programmes remain targeted to the most disadvantaged job-seekers and regions and that their impact is closely monitored.

The "Joint assessment of employment policy priorities in Lithuania" (2002) noted that there is a need to expand active labour market programmes and

to rebalance provisions away from temporary work in favour of training and other measures designed to increase employability. Also, passive policies need to be reformed, in particular, unemployment benefits and social assistance to the unemployed should be reformed in order to improve coverage, eliminate disincentives and emphasise action rather than passive receipt of benefits. The public employment service should play a more active role in reintegrating the unemployed, therefore a detailed action plan for its reform should be developed and the service's resources should be increased.

The joint report of Latvia and the European Commission indicated the following areas where the country must progress further ("Joint assessment of employment policy priorities in Latvia", 2002):

- the current structure of unemployment benefit payments needs to be developed further, while improving social assistance provisions to those unemployed who are not entitled to benefits;
- an active strategy of supporting job searches and employability should be implemented, to do so efforts will be required to raise the level of registration of the unemployed with the State Employment Service;
- expansion of active labour market programmes should be targeted to disadvantaged groups on the labour market by giving preference to training and human resources measures over those providing only temporary public work programmes.

We can conclude that unemployment benefits are small because labour market policies in the Baltic countries are underfinanced, therefore they do not reduce labour market flexibility. On the other hand, by putting a stronger emphasis on active labour market programmes, the positive impact of labour policy on labour market flexibility can be increased. In this context, more attention should be paid to education and training, including development of lifelong learning which is now an established priority throughout the EU. This will also increase employment security as it makes it easier for those who lose a job to find a new one.

4.3. The role of trade unions and wage flexibility

In most western and northern European countries, trade unions have a significant role in wage determination. Even though the number of unionised workers varies greatly among European countries, from almost 80% of employees belonging to unions in northern Europe to less than 20% in southern Europe, collective agreements are usually extended to non-

unionised workers, too. In the Baltic states as well as in the other central and east European countries the role of trade unions is less influential. In the Baltic states, as well as in the other central and eastern European countries, the role of trade unions is less important. As Table 5 shows, in the late 1990s, the partial trend towards decline had become rather general. On average, union density in the EU declined from 32.6% in 1995 to 26.4% in 2001, a decline of one percentage point per year and there was an even more remarkable decline in membership in new member states. Actually, the importance of trade unions has been decreasing in all the central and eastern European countries since the 1980s. Whereas at the end of the 1980s the whole labour force were trade union members, by the middle of the 1990s the number had dropped to between 30% and 60%. At the end of the 1990s, trade union density was under 35% in all the transition countries except Slovenia.

Table 5 – Trade union density rates (%)

Country	1990	1995	2001	2002
Estonia	90.6	31.6	16.6	–
Latvia	–	30 ^a	–	20
Lithuania	–	40 ^a	–	16
Average EU-25	–	32.6	26.4	–
Average EU-15	32.8	31	27.3	–
Average EU-10	–	42.7	20.4	–

Source: *Industrial relations European Commission*, 2004, p. 19; Riboud et al. (2002).

The Baltic states introduced national-level bargaining already at the beginning of the transition process. National-level bargaining took place mainly in tripartite bodies, which included representatives of the government, employers and unions. One of the main tasks of national-level bargaining is to decide the level of minimum wage. Today, at least in Estonia, these negotiations take place only between social partners, without the government. Other questions in the bargaining have been reforms of labour market legislation, social reforms and pensions.

Besides national-level agreements, company-level agreements are the most common in the Baltic states. The initiative to bargain is usually taken by trade unions. It should be noted that employers are not interested in concluding collective agreements but are under a legal obligation to conclude them if their employees wish to do so. In practice there are often disputes where employers attempt to avoid signing agreements. Most company-

level agreements are concluded in the public sector, in large public-sector businesses or in privatised companies. Company-level bargaining is remarkably less developed in foreign companies (Due and Mailand, 2001).

The estimates about company-level agreements coverage in the Baltic states vary:

- According to Due and Mailand (2001), the coverage by collective agreements in Estonia is 6% to 14%. According to the data from the largest union in Estonia, in the year 2000 about 14% of workers were covered by company-level collective agreements. (According to the same source, 16% of employed persons in Estonia are trade union members.)
- In Latvia, Due and Mailand (2001) report the coverage to be between 10% and 30%. (They report the rate of unionisation to be between 10% and 40%. According to Antila and Ylöstalo (1999), Latvia is the Baltic country with the highest rate of unionisation at 25%.)
- In Lithuania, Due and Mailand (2001) report the coverage to be between 10% and 30%. (Antila and Ylöstalo (1999) report the union density in Lithuania to be 15%.)

It can be concluded that trade unions in the Baltic states are rather weak in terms of both union density and collective agreements coverage. Collective agreements are more common at company level or national level. At sectoral or regional levels, the bargaining process is less developed. We can thus conclude that most employees in the Baltic states rely on individual employment contracts. As most employees are not covered by collective agreements, the effect of labour unions on labour market flexibility is currently marginal.

The main reasons for the minor importance of unions in the Baltic states can be found in the general labour market developments. In the 1990s, industrial employment in the Baltic states declined drastically, which directly led to a drop in union density, because in the Baltic states, like in most other countries, unionisation rates are generally lower in the service sector. The increase in the number of small businesses, where due to the small number of employees unions are generally rarer, has also led to lower union membership. The general trend of decreasing union membership has been causing the organisations financial problems. And finally, one of the most important reasons that has decreased the bargaining power of unions in the Baltic states is the rising unemployment during the past decade.

4.4. Wage flexibility

If trade unions are relatively weak, then it is not so surprising that wages are relatively flexible in the Baltic states.

Analysing wage flexibility in the Baltic states, it is possible to admit that on the whole wage systems are rather flexible, but there are also differences between the countries and economic sectors. Nominal wages are most rigid in Lithuania and most flexible in Estonia. At the same time, minimum wages are lowest in Estonia and highest in Lithuania.

We found surprisingly that in the Baltic states we can even see downward flexibility of nominal wages. After the Soviet financial crises in 1998, in some sectors such as construction, but also in fishing, agriculture, and the hotels and restaurants sector, average nominal wages declined. The least flexible wages were found in the public sector and in the financial sector.

The data also confirm that if the wages are low, they are also more flexible. In the context of EU enlargement, it is possible that wages in those sectors where they are most flexible will converge faster with the EU wage level, if EU labour market policies are liberalised. It may also happen that if the Baltic states' labour markets become as highly regulated as those of the EU, wage flexibility will decrease in all the three countries, but especially in Estonia. The last option is rather realistic.

5. Labour flexibility and flows

5.1. Flows between three labour market states

In this section we analyse flows between different labour market states. While much research exists, there are no papers on the Baltic countries other than Estonia. Thanks to good labour force survey data there are several papers published about the Estonian labour market. Some analyses concerning Estonian labour market flexibility issues have been made (see, for example, Haltiwanger and Vodopivec (2002), Juraida and Terrell (2001), Arro et al. (2001), and Faggio and Konings (2003). The common result we can draw from these analyses was the fact that in the early years of transition, the Estonian labour market was characterised by relatively high transition rates both in the case of jobs and workers. If we compare these findings with the relatively moderate increase of unemployment in the early years of transition, we can draw important conclusion that

one of the reasons for the low unemployment was high labour market mobility, in the sense of job and worker flows.

Table 6 – Basic flows between three labour market states

	Estonia			Latvia			Lithuania
	1997/ 98	1998/ 99	1999/ 2000	1997 /98	1998/ 99	1999/ 2000	1999/ 2000
EE	0.932	0.906	0.905	0.904	0.911	0.901	0.883
EU	0.032	0.050	0.054	0.058	0.055	0.039	0.059
EO	0.037	0.044	0.041	0.039	0.034	0.061	0.058
UE	0.332	0.320	0.279	0.272	0.265	0.304	0.340
UU	0.599	0.604	0.652	0.586	0.544	0.483	0.459
UO	0.069	0.076	0.069	0.142	0.191	0.213	0.201
OE	0.079	0.059	0.061	0.050	0.044	0.061	0.077
OU	0.028	0.025	0.032	0.038	0.029	0.017	0.042
OO	0.893	0.916	0.908	0.913	0.927	0.922	0.882

E: employment; U: unemployment; O: non-participation.

As with other countries in transition, the pools of employed (EE) or out of labour force (OO) were fairly stagnant because of the relatively high probability of staying in them. At the same time, the pool of unemployed is fairly different in the three Baltic states. The probability of staying in unemployment is high in Estonia (0.65),⁶ while it is pretty low in Latvia (0.48 in 1999/2000) and even lower in Lithuania (0.46).⁷ In the Latvian case it has dropped from 0.58 to 0.48 during the three years under observation. One explanation for such differences is probably the increasing number of discouraged workers in Latvia and Lithuania.

If we look at flows from unemployment to non-participation (UO), then we see a drastic increase in Latvia. The probability of moving from unemployment to non-participation is also relatively high in Lithuania (0.201),

6. This means that 65% of those who were unemployed in January last year are unemployed in January this year.

7. For details of this overview, see Eamets (2004).

while in Estonia the corresponding number is only 0.069 and it has been rather stable.

To summarise findings from earlier work we can say that worker flows were relatively high in the early 1990s then they started slowly to decline, but even today they have remained higher than in the EU member states on average.

5.2. Job flows

We start the review of the empirical results with the job flows (job creation and destruction) indicators. This strand of empirical research has gained importance since the paper by Davis and Haltiwanger (1992) was published and has produced a lot of evidence from western countries. By now several papers studying job flows in transition economies have been published (for instance, Konings et al. (1996) about Poland; Basu et al. (1997), and Estrin and Svejnar (1998) about the Czech Republic, Slovakia, and Poland; Brown and Earle (2002) about Russia; and Rutkowski (2003) about Lithuania). The main findings of that literature, as summarised by Haltiwanger et al. (2003), are that (1) in early transition, job destruction dominates job creation, whereas at later stages job destruction and creation are roughly equal; (2) there was a large increase in worker flows⁸ when the transition began; (3) small and new private firms contribute to job creation disproportionately, while most of the job destruction occurs among state-owned firms; and (4) within narrowly defined industries there is vast heterogeneity in job creation and destruction, but inter-industry reallocation is still more important than in western economies.

The empirical literature has shown that the destruction and creation of jobs are largely simultaneous processes and that is what we can also see in our data (see Figure 1).⁹ Our estimation of the gross job flows, 26%,¹⁰

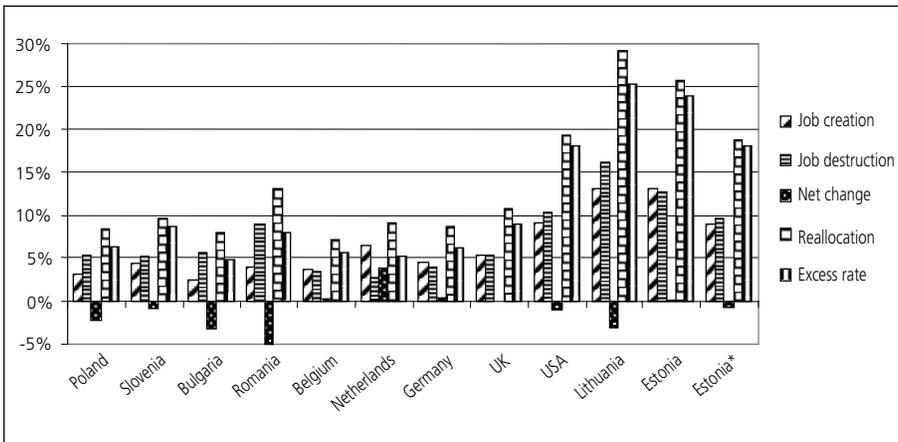
8. Worker flows are related to job flows as follows. The sum of job creation and job destruction induces the maximum amount of worker reallocation induced by the flow of jobs between firms, while larger job creation and destruction equal the minimum worker reallocation (Davis et al., 1997).

9. More detailed analyses of job flows in Estonia are presented in Masso et al. (2004) "Job creation and job destruction in Estonia: labour reallocation and structural changes".

10. Gross job flows in Estonia have been estimated by several authors using different data sets (see Faggio and Konings (2003), Haltiwanger and Vodopivec (2002), Eamets (2003) and Venesaar (2003)). Previous analyses, which used different business data

is rather high in international comparison, and is similar to the level of the United States. The most important job flow indicator, the excess rate, is 24%, indicating rather high labour market flexibility in Estonia compared to the central and eastern European and the western European countries (see Figure 1). The average excess rate of labour allocation was 18% in the US, 9% in the UK and only 6% in Germany. The excess rate in Estonia is somewhat lower if we exclude small firms, but is still almost equal to its US counterpart. A similarly high excess rate (25%) was found by Rutkowski (2003) for the other Baltic state, Lithuania (1996-2000), and in late transition for Russia (24%).

Figure 1 – Indicators of job flows in Estonia in international comparison (% of employment)



Note. For Estonia, the data were for the period 1995-2001; for the USA, 1973-88; for Belgium, 1989-95; for the Netherlands and Germany, 1988-95; for the UK, 1987-95; for Romania, 1995-97; for Poland, Slovenia and Bulgaria, 1994-97; and for Lithuania 1996-2000. Estonia* denotes the results from the Estonian Business Registry database using only firms having at least 100 employees.

Source: Estonia: authors' calculations; USA: Davis et al. (1997); Lithuania: Rutkowski (2003); and other countries: Faggio and Konings (2003).

sets (AMADEUS, Statistical Office database, etc.), are likely to have underestimated the actual job flows, their data sets contain mainly larger companies and only a fairly limited number of smaller ones.

6. Discussion: the flexicurity paradox in the Baltic states

The flexicurity concept as a policy option is not very easy to implement in transition economies. Most of these economies benefited from strong labour protection and generous social benefit systems during the planned economies. The opening up of the national economies to global competition has forced domestic companies to adjust their inputs, including labour, to market demand. Within the structural adjustment package, introducing employment flexibility and lowering social protection was in most cases offered as the sole means of transforming labour markets to new market conditions. As a result the low administrative capacity of labour market institutions and weakness of trade unions combined with poor law enforcement have contributed to actually higher labour market flexibility and job insecurity felt by workers. It is important to understand that in order to converge with western economies these countries should keep relatively liberal economic policies, which means a flexible labour market with strict monetary and fiscal policy. According to optimistic estimations it will take at least fifteen to twenty-five years in order to achieve real convergence.

Our overview of some flexicurity indicators, like worker protection, trade union influence and job flows and worker flows tell us the following story.

Labour markets are highly flexible in terms of labour market flows and especially in terms of job flows. We only had data about Lithuania and Estonia, but these data show us that job creation and destruction rates are much higher than comparable numbers in older member states and even higher than in the US which is considered to be an economy with very high labour market flexibility.

From a formal point of view the legal regulation of the labour market seems to be in place and the worker is even better protected in the Baltic states than in the EU. But in practice, it appears that state regulations are not always followed in the private sector and there is still substantial evidence of violations of these regulations by companies in the Baltic states. Workers' complaints to labour inspectors are rather frequent and in labour disputes employees' appeals are rather often followed, which may indicate that law enforcement is not that weak.

From a social cohesion perspective, we should admit that the Baltic states have a very long way to go. Estonia has the highest Gini coefficient in the EU, in Latvia and Lithuania the situation is quite similar. Estonia is an

extreme example of liberal market-oriented economic policy and lowered its personal income tax rate from 26% (2004) to 23% (2006). This is a flat tax, so lowering the flat tax rate will probably not help to lower the Gini coefficient.

Increasing social disparities, high gender wage gap and low income levels are keywords that characterise the social situation. Social policy systems as such are in place, but the general income level is very low. For instance in Estonia the minimum wage is 34% of the average wage; it is somewhat higher in Latvia and the highest in Lithuania (around 40%). A generally low income level and particularly low minimum wages are weak incentives for people to look for a job. Kuddo et al. (2002) calculated the replacement rates of subsistence benefits and family benefits for different family types in 2000. The replacement ratio to average net wages¹¹ was 33% for a single person,¹² 27% for a couple, 39% for a couple with two children and 48% for the single parent with one child. These numbers do not decrease over time. When calculating them relative to minimum wage, it turns out that these are 100% for the single parent with one child and 85% for the couple with two children. This shows that the incentive to take up a job at the minimum wage is low for these family types (Kuddo et al., 2002).

Family support to young people exists also, and often parents support their children after graduation into their first work years. But as young people try to move to live separately from their families as soon as there are financial possibilities, this family support and social links are beginning to weaken. We can see the same tendencies all over the developed countries, especially the northern and central European countries, but less in southern Europe. As the Baltic states belong culturally to the German or Scandinavian area it is inevitable that these kind of family ties lose their importance.

If we want to have more flexicurity, we will need mainly two things: time and active policy from government. By time we mean that there are certain time periods we have to consider, while nominal and real convergences in the Baltic economies will take place. It is very difficult in low income countries to explain to simple workers that in order to make labour markets more flexible we need to have more part-time work, when his or

11. Relative to 66.7% of the average wage of the production worker.

12. The ratio of unemployment benefits relative to the 66.7% of the wage of the average production worker was 16%.

her intention is to do more overtime work and earn more income. Almost 50% of part-time workers in Estonia would prefer to work full time.

However there are aspects which could be implemented now. As we learned from previous sections in this article, labour policy is not sufficiently financed by the state. A more active labour market policy is needed. During the last two years the tendencies have been positive in this development. Mostly thanks to European Union financial aid the share of labour market expenditures increased from 0.19% in 2002 to 0.32% in 2004 in Estonia. These are significant changes, but compared with the EU average levels the gap is still very big.

Active labour market measures are still underdeveloped; the same is true if we look at on-job-training practices. The firms' interest is not sufficient to guarantee intra-firm training. Our surveys in Estonia have shown that only large companies provide enough training for their employees. The majority of firms in Estonia and also in Latvia are still micro-businesses, with less than 10 employees. In such circumstances, the only way to implement instruments of lifelong learning is a state labour (training) policy. Today the share of active labour market policies has grown in all three Baltic states due to EU support. Unfortunately small countries often face a shortage of competent people and companies that may use rights drain away extra financial sources. This is the old problem of the public sector's administrative capacity to absorb and implement additional funds from the EU.

One very important issue stressed in flexicurity strategies is mutual trust. Both employers and employees should trust each other and they should realise that it is possible to implement measures that increase flexicurity, as has happened both in Denmark and the Netherlands.¹³ If we look briefly at the situation in the Baltic states, then again we should admit that the situation is unsatisfactory. If less than 20% of workers belong to trade unions and collective agreement coverage is less than 30%, then it is very difficult to talk about partnership, mutual understanding and mutual trust. There are sectors where collective bargaining is relatively well developed: education, health care and in some cases transportation, mining, etc. However, these are exceptions not rules. There are sectors where trade unions do not

13. This is one very important point, why do we need more time and why it is very difficult to implement these ideas at least in the Baltic states. It is obvious that first we need to have equal partners in the social dialogue, and only after can we start to talk about creating mutual trust between partners.

exist at all in Estonia and these are not just small sectors, but construction and banking for example where unions have a marginal role.

7. Policy implications

As it was mentioned by Wilthagen (2004) that “the main message of the flexibility concept is that in modern labour markets labour flexibility should (also) be defined in terms of security as well as the security should also be defined in terms of flexibility. Put differently, flexibility and security are not incompatible but should rather be seen as two sides of the same coin as the mutual preconditions”.

The conclusions from this statement could be that flexible labour markets need more security, but a different type of security, compared with what they have today and vice versa (Wilthagen, 2004).

If we think about policy options then we can say that every policy option or institutional tool could be treated from two sides: flexibility and security. One means of presenting this is to use a simple matrix format where we link the tool and the two aspects of flexicurity (see Table 7).

The last two policy instruments presented in the table are also very relevant in the context of the Baltic states. For instance early retirement schemes are increasingly popular in Estonia. In older member states this problem is even bigger. In many new member states, the state social benefits are very low and do not guarantee even a minimum level of subsistence. Social assistance benefits in Estonia are means tested and in 2004 were about 7% of the average wage. This is not sufficient support to cover elementary expenditures.

Several aspects mentioned in the table are unequally developed in new member states. For instance temporary agency work is widespread in Latvia, while in Estonia we do not have much evidence of that, yet. But there are definitely different aspects which could be considered, and therefore this table should be treated as simply an example of how it is possible to implement policy instruments to develop flexicurity in labour markets. Maybe there are common problems and similar solutions in all member states, but we tend to believe that such instruments and policy options should be country specific.

Table 7 – Policy instruments in the framework of flexicurity

Policy instrument	Flexibility	Security
Labour protection legislation	Shortening notice time and lowering severance payments	Better guarantees for temporary workers
Trade unions	Less restrictive migration policies (between member states). Need changes in attitudes	Collectively agreed guarantees for more vulnerable employee groups: temporary workers, part-time workers, youth, etc.
Social policy	Reduction of early retirement schemes/variable retirement schemes	State support for inactive people without income or long-term unemployed should cover at least minimum subsistence level
Labour policy	Period in which one receives unemployment benefits could be shortened	More stress on active labour market programmes, such as training. Governmental support schemes to SMEs to introduce intra-firm training

8. Conclusion

To conclude we can say that the European social model with workers' solidarity and labour protection is an inevitable part of the modern European Union. At the same time, the European economy is losing its position in the world market competition. Labour-intensive jobs are moving to Asia while innovation and technology achievements are concentrated in the United States. One important way to move ahead in economic competition is to make labour markets more flexible in Europe. This concerns especially the older EU member states.

As I tried to show in the previous sections, it is possible to gain more flexibility and improve employment protection of more vulnerable groups in the labour market. These policy options require changes of attitudes and understanding. If different social actors in society will not work together and achieve mutual trust the implementation of flexicurity ideas is not possible.

The Baltic states are in a way a special case in the EU. These small and open economies implemented very radical economic changes, and in general we can say that labour markets are very flexible in these countries. Despite the fact that labour protection is formally well developed, in many cases laws are simply not followed. Also the state apparatus responsible for law amendment is not sufficiently developed and strong. By apparatus I mean labour inspectorates and health protection agencies. Also the role of trade unions is marginal.

It sounds paradoxical, but in order to achieve more flexicurity in the Baltic states, these countries' labour markets should first become more rigid in order to provide sufficient protection to the labour force. As was mentioned before, there are two things we need: time and active policies from government. Time is needed for nominal and real convergence, and active labour policy allows for faster reaction of the labour force to external shocks via training activities.

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III – Reconciling labour flexibility with social cohesion in eastern Europe – The case of Bulgaria

Katja Vladimirova, Professor of Human Resource Management at the University of National and World Economics (UNSS), Sofia (Bulgaria)

Introduction

A lack of access to employment and training as well as a shortage of income to cover day-to-day needs lead to a sense of insecurity that ultimately derives from a fear of poverty, hunger and violence. Overall security is consequently contingent upon social protection, employment security, security in the event of unemployment as well as income and job security.¹ A sense of personal security stems, therefore, from the safeguarding of individual rights, particularly those rights giving access to paid work, social protection and an adequate income to sustain a dignified life. In short, security derives from respect for fundamental rights.

The constitutional legislation of central and eastern European countries – and even, to a large extent, their labour legislation – contains all the key provisions guaranteeing the right to work as well as freedom and protection of employment. The state has an obligation to bring about the necessary conditions for the realisation of all of these rights, which engender security and freedom. As the reality of labour flexibility in these countries shows, however, in many cases such rights are neither realised nor universally accessible.

Moreover, in any discussion of social cohesion in eastern Europe, it must be remembered that these countries no longer form what was once widely considered to be a homogeneous unit. Each society in the region has undergone its own transformation.

As well as generating numerous opportunities, political and economic reforms in these countries have led to considerable insecurity. Neither society nor individuals were prepared for this. People were socialised

1. Insecurity is defined as a lack of security, and security as an objective situation in which there is no danger, or the situation of a person who feels safe from danger. See *Larousse*, Paris, 2001, pp. 455 and 782.

for a different system. The shift to another form of social and labour organisation, to a different system of values and behaviour specific to the market economy, is by no means an easy one. It calls for time and effort on the part of social groups and individuals.

In Bulgaria, the transition to democracy and a market economy was coupled with high inflation and bank failures along with savings and job losses. It gave rise to individual coping and survival strategies, which prompted many people to withdraw into themselves and their family units. The collective way of life and the subordination of individual objectives to public, collective goals were quickly destroyed.

The future became clearer in the late 1990s as the country embarked on the process of European Union integration. This is one of the few rallying points for Bulgarian society reflecting a desire to which most of the population subscribes. For the majority of citizens, however, shared common values and a vision of policies and social cohesion incorporating a certain level of social security and a high employment rate – in short, what could be called the European social model – are still unfamiliar or poorly understood.

The level of employment flexibility within the Bulgarian labour market is relatively high. The little security citizens do have is confined to the security and amount of income enjoyed by those in work; it is weakened by delayed wage and salary payments as well as low welfare allowances and benefits. Much of the population consequently suffers from insecurity: those on low wages and salaries, those working without an employment contract and/or within the unofficial economy, the unemployed and, above all, those outside the labour force. Many people are out of work (unemployed or outside the labour force) or on low incomes (senior citizens and welfare beneficiaries), and thus in a situation of social insecurity. This is compounded by the lack of physical safety in the street, for either property or people's lives. All of these factors combine to create a widespread sense of collective insecurity, highlighting major problems in respect of social cohesion.

The government started looking at the issue of labour flexibility in the year 2000, but solely as a possible means of reducing unemployment.

So far, however, economic development based on flexibility and insecurity has been an impediment to social cohesion and harmony between the generations. Insecurity has given rise to competition and conflict in the employment arena. In the final analysis, the values underpinning social cohesion have been undermined.

The fairly widespread practice of unregulated employment relationships and deficient social security arrangements in many companies, inadequate and irregular remuneration, the fact that the quantity and quality of work performed bear no relation to earnings and adverse working conditions are some of the fundamental reasons underlying changing attitudes to work. The place of work in the Bulgarian value system has altered considerably, particularly among young people. Many of them no longer view it as a source of well-being and personal fulfilment. As a result, the unemployed and “disheartened” have few incentives and little motivation to return to work. Research shows that some of the unemployed and “disheartened” opt instead for permanent reliance on alternative sources of income (welfare benefits and/or employment in the unofficial sector).

The Bulgarian situation is therefore more a vicious circle, a downward spiral, than a path to prosperity and social cohesion by means of flexibility. The key question raised in this publication is that of how to reconcile labour flexibility with social cohesion in the specific context of eastern Europe. Before we can answer it, we must first look at the institutional and historical background, which will be discussed in the following sections. These two aspects must be reconciled not only in order to improve the social situation, but also, as this publication shows, as a way of breaking the vicious circle that all too often takes hold, by identifying strategies for attaining the “high road” of development in which social and economic performance reinforce one another.

1. Transition to a market economy and changing values

The transition to a market economy involved different processes and approaches in each country, with differing social consequences. All the countries underwent far-reaching economic reforms during the first half of the 1990s. It was necessary to create and develop markets, including the labour market, to change the employment model and to formulate suitable policies for dealing with the social problems arising as a result of privatisation, structural reforms, unemployment and the impoverishment of the population.

In most countries, the transition to a market economy proved to be a lengthy one, with a high social cost. The reforms and economic restructuring models and approaches that were adopted reduced production and employment, and tightened the demand for labour. The labour market was created and employment policies introduced without too many problems, but the country’s ability to cope with the social consequences of

the reforms was limited. Jobs had been subject to considerable protection up until 1990. The existing system of vocational training and retraining gave workers a sense of security, as did the social and health insurance schemes. On the other hand, it created conditions that were not conducive to productivity growth or economic development. Overall, changing the employment model had the effect of increasing flexibility and social exclusion, and reducing security and social cohesion.

A radical change in values took place at the same time, involving a shift from a high degree of social security provision by the state to a model in which individuals have to manage on their own. This left a sense of insecurity. The passivity developed over several decades under the socialist system and people's inexperience in coping with the challenges of the market further exacerbated the feelings of exclusion and insecurity.

1.1. Economic restructuring: geographical relocation and identity crises

Bulgaria is one of those countries in which the transition process has suffered its bitterest defeats.² Although economic growth has been relatively high since the year 2000, with employment gradually increasing, production has not yet reached 1988 levels. Unemployment rose as a result of massive redundancies following the liquidation or privatisation of companies and the sharp drop in demand for labour, reaching massive, tragic levels among many occupational groups. Overall, unemployment in Bulgaria remained high throughout the transition period, averaging between 12% and 21%, with much higher peaks for some occupational, age or ethnic groups. Bulgaria recorded the greatest drop in employment among those countries in transition.³

With the removal of administrative restrictions on the internal and external movement of labour and the start of the profound, ongoing economic recession, there was an exponential increase in external and subsequently internal migration. The main purpose of this geographical flexibility was

2. The drastic fall in production continued for about ten years (in 1997, GDP was at 45.2% of its 1988 level). *Statistics Yearbook*, National Statistical Institute, Sofia, 1999.

3. A 34.3% drop was recorded between 1989 and 2000, compared with approximately 17% in Romania (1987-90), 9% in Hungary (1992-98) and 4% in the Czech Republic (1985-93). See Vladimirova, K., 2004, p. 57; and National Statistical Institute, Employment and unemployment, 2/2004, Sofia, 2004, p. 28.

to find work and/or higher wages and salaries.⁴ It considerably reduced the population of many towns and villages, further speeding up processes such as population ageing, depopulation, impoverishment and exclusion in many regions. The “brain drain” is having a severe impact on Bulgaria’s development prospects.

In many cases, the considerable movement of labour between sectors, economic branches and regions was a necessity. It was hardly ever a voluntary decision. Most flexible workers had no other prospects.

The movement is now mainly from the public to the private sector and from industry to services, but people are also moving into unemployment and exclusion from the labour market.⁵ The significant development of forced mobility between economic sectors and branches has increased the lack of job security. The speed of the deindustrialisation process threw out much of the workforce, leaving it jobless and without any income.

At the same time, changes in employment status increased both flexibility and insecurity. New arrangements were introduced, along with new concepts within existing arrangements: employers, self-employment, employees and unpaid workers. Some of the new employers (nationals and foreigners) provided fewer guarantees and less security, and working conditions deteriorated.

Flexibility and the lack of job security were heightened as a result of the development of the private sector. Greater flexibility and insecurity also stem from a structural cause: changing industrial relations between small and large companies. Many large and medium-sized public-sector companies have been closed. Most new businesses are small or very small. In its reforms introducing a market economy, Bulgaria was counting on small- and medium-sized private companies to increase employment and

4. More than 690 000 people left the country between 1989 and 2003, representing 7% of the country’s 1989 population. See Kaltchev, Y., “Profile of potential emigrants from Bulgaria: gender aspects”, Seminar on Gender Dimensions of the New Migration from Bulgaria – Policy Recommendations, Sofia, 2005.

5. Vladimirova, K., “Emploi et protection sociale en période de transition de la Bulgarie vers une économie de marché”, in *Statuts d’emploi, contrats de travail et sécurité*, MSH and Stopanstvo University Press, Sofia, 2003, pp. 237-58.

flexibility, and to make production more economically efficient.⁶ Small- and medium-sized businesses offer very flexible employment, but relatively little job security. In Bulgaria, a company's size is a decisive factor when it comes to labour flexibility and job security. Large businesses theoretically provide greater job security, while small- and medium-sized ones have considerable flexibility and a high turnover. Small businesses have had more redundancies in recent years.

These changes have had a significant social impact, for the rapid, far-reaching economic restructuring has modified the occupational structure and the gender breakdown in different occupations. A drop by half in the proportion of employees working in industry (from 44% to 26%) and an abrupt increase in the proportion working in the service sector interrupted many people's careers, especially those of women. Most engineers, technicians and agricultural experts (with university degrees or secondary school qualifications) lost their jobs and have never been able to return. Some of them moved into the service sector, while others became long-term unemployed. In addition to the tremendous loss of human capital and specific skills, these people lost their sense of professional identification and thus part of their own identity. They went to work in areas bearing no relation to either their level of education or their professional training and experience. They have come to see a job as something random and insecure, which no longer assigns a clear role within society.

Women have been particularly harshly affected by this loss of their social role: severe budgetary restrictions coupled with falling production and the restructuring process have significantly reduced the number of employees in the research sector, previously dominated by women.

6. They accounted for 99% of all companies in 2002, and 54% of all workers. Micro-companies account for 91% of all small- and medium-sized enterprises (SMEs), but provide only 48% of jobs in such companies. It follows that the majority are micro-companies (with one or two employees). Small companies account for 6.7% of all SMEs, and 34% of their employees; the share of medium-sized companies is insignificant (1.1% of all SMEs, and 17% of their employees). See "The development of small and medium-sized enterprises in Bulgaria", Report by the Agency for Small and Medium-Sized Enterprises, Sofia, 2000, p. 55, and 2000-2002, p. 40.

1.2. Limited access to the labour market: large groups of unemployed or “disheartened” people generate an individual and collective sense of insecurity

During the transition years, one of the most widespread forms of “mobility” has been the shift from employment to unemployment or people leaving the labour force. This has generated and compounded other forms of insecurity.⁷ Throughout the transition period, there have been several times more people out of work than the number of private-sector jobs on offer. The ranks of the registered unemployed are dominated by women, young people, those over the age of 50, the unskilled and the long-term unemployed.⁸ The latter account for more than half of all unemployed people, and most face a number of disadvantages. They have no occupation and little education; many of them are older people, young people or Roma.

Registered unemployment has fallen in recent years, partly as a result of the increasing number of “disheartened” people leaving the labour market. The growing number of people outside the workforce, on welfare benefits or living on the margins of society reflects a population shift away from the workforce and, to a lesser extent, from unemployment into employment. Bulgaria has one of the lowest levels of employment and one of the highest levels of unemployed and disheartened people. Much of the working-age population is in fact outside the labour force and thus the social security system. This situation affected more than 1 million people in 2004, and still affects nearly 800 000, while the country has fewer than 3 million employees in total. Younger and older people are most affected, accounting for more than 20% of those outside the labour force. People over the age of 55 tend to be disheartened rather than unemployed, as they are the least likely to find jobs in the new economy.

Many disheartened men and women have lost their jobs. However, the number of disheartened people – especially young people – who have never been able to enter the labour market now exceeds the number of people leaving it. This is an extremely negative trend, since it shows that the country’s social and economic context has nothing positive to offer

7. In recent years, the average annual unemployment rate in Bulgaria has exceeded 10% of the workforce (17.9% in 2000 and 2001; 16.3% in 2002; 13.5 % in 2003; and 12.2% in 2004). *Statistics Yearbook*, National Statistical Institute, Sofia, 2005, p. 63.

8. According to figures supplied by the Employment Agency, Ministry of Labour and Social Policy, Sofia, 2003.

these people. They lose hope that they will one day be in a position to hold a stable job paying more than the minimum wage.

Because this situation affects a sizeable proportion of the population, social development as a whole is put to the test. Poverty and illiteracy are being passed on from one generation to the next. The considerable insecurity faced by much of the population impacts society as a whole, giving rise to an individual and collective sense of insecurity. The large number of poor people, and especially very poor people, increases the crime rate and the level of non-compliance with the standards adopted.

Falling unemployment in recent years may also be ascribed to a lull in the processes of privatisation and liquidation of loss-making enterprises, but above all to a particular type of active employment policy offering subsidised jobs that often last no more than a few months. These government-supported jobs turn out to be more a statistical measure than an indicator of economic activity. The development of this “secondary market” in its current form tends to result in greater insecurity for job-seekers (see also section 3.2), raising the issue of the economic and social cost of jobs created for the long-term unemployed.⁹

Many unemployed people are in a difficult position within the labour market (young people, women, people with disabilities, senior citizens and ethnic groups). Individual characteristics such as age, gender, ethnic affiliation and physical and mental health afford plenty of opportunities to exclude people from the labour market. The extremely limited demand for labour greatly increases the level of competition among job-seekers. Given these circumstances, those with fewer labour market prospects may find themselves excluded, remaining out of work and outside the social security system. The process of exclusion from the labour market has a snowball effect on some members of such groups. They remain unemployed for a long time, with many of them becoming “disheartened” and leaving the labour market to join the large number of Bulgarians outside the labour force, including people without a regular income or on low incomes who do not have any social security coverage. This gives rise to a vicious circle of exclusion, social fragmentation, poverty, insecurity and often crime, from which many are no longer able to break free.

9. For example, over 40% of posts declared vacant to the National Employment Agency in 2002-04 came under active employment policy programmes; this means that programmes to foster employment have a strong influence on the labour market. Data source: Employment Agency, Ministry of Labour and Social Policy, Sofia, 2003.

The fact that certain groups – particularly Roma, few of whom work in the official economy – fail to pay many contributions and taxes and the high level of crime (theft) result in further divisions and conflict within the population and foster xenophobia, hatred and negative stereotypes.

Massive long-term unemployment, high inflation (and even temporary hyper-inflation) and restrictions on state transfers have drastically reduced people's real income (which has fallen more than 50% since 1989). The proportion of earned income has decreased, while the proportion of income derived from welfare funds and family-based production has grown. Much of the population has become poorer; a significant section has fallen below the poverty line; and a tiny section has become a good deal richer. Social fragmentation, disintegration and marginalisation have increased.

Job security issues were underestimated because radical changes in the number and types of jobs available were seen solely as necessary processes in the transition to a market economy, without any consideration being given to their secondary impact or whether they would actually make it possible to achieve the objectives pursued.

1.3. The unofficial economy: a source of insecurity and flexibility

It is common for countries in transition to have a large unofficial economy, and Bulgaria is no exception. This sector was thought to make up a substantial proportion of the economy in the mid-1990s (up to 35-40% of GDP); according to various studies conducted in Bulgaria, that proportion has dropped in recent years (by 16-25%).¹⁰

Employment in the unofficial economy – that is, “hidden employment”¹¹ – represents a sizeable proportion of that section of the workforce employed in temporary jobs, usually without any job security. The main branches with a high degree of hidden employment include agriculture, the service sector, the building sector, tourism and industry, that is, virtually every

10. “Labour market flexibility and job security in the central and east European countries and the Baltic states”, paper on the Republic of Bulgaria, ILO, Sofia, 2004; and “The hidden economy in Bulgaria”, Centre for the Study of Democracy, Sofia, 2004.

11. Unofficial employment is defined as jobs without an employment contract or jobs where total earnings are not declared, with no payment – or only minimal payment – of social security contributions.

branch except the public sector.¹² Typical forms of unofficial employment include second jobs without a contract, which are often necessary due to low official salaries, and employees claiming to be “self-employed” or working in family businesses without a contract, without any payment of social security contributions or record of their income. There are also highly qualified executives who work without a contract or any payment of social security contributions despite earning high salaries.

The government has taken action to curb unofficial employment in recent years, by introducing a requirement for employers to register employment contracts and by exercising more stringent supervision over the payment of social security contributions and so on.¹³ Health reforms are also expected to help reduce unofficial employment and increase official employment and social security coverage. One of the causes of “hidden” employment is the level of income tax and social security contributions. Home-based work is still unregulated. Virtually no home-based workers have employment contracts or social security coverage. In some cases, their income is well below the minimum wage.

1.4. Changing values

The new constitutions adopted in central and eastern Europe now focus on individual rights. There has therefore been a major change of emphasis, reflecting the shift from collectivist institutional structures to institutionalised individualism. Individualisation through privatisation in the Balkan countries has generated unemployment, poverty, ethnic conflicts and new forms of alienation. Insecurity has rapidly gained ground. The means of production were privatised without proper – if any – compensation for the community. Rising crime, a trend that started during the reform process, is the most serious aberration resulting from individualism.¹⁴

12. According to figures from a 1999 paper, companies fail to declare some 35% of their labour costs, and 10-50% of the wages and salaries paid. See *The shadow economy in Bulgaria*, project by the Agency for Economic Analysis and Forecasting, Institute for Market Economics, Harvard University, 2000.

13. A 2003 amendment to the Compulsory Social Security Code instituted a new system for registering employment contracts with a view to ensuring that more of the country's employees were covered by the social security system.

14. Genov, N. (2000) *Global trends and east European societal transformations*, Sofia.

The changes undermined two fundamental pillars of east European tradition: egalitarianism and the crucial role assigned to the state, of which society has huge expectations.

Many sectors of the population are suffering from the impact of destabilised institutions and rising crime. The main cause of instability is the social decline of sizeable sectors of the population, which then find themselves at the bottom of the social ladder. Faced with this kind of social mobility, people are more inclined to react to the lack of security by adopting individualist ways of thinking and behaving. There is little room for solidarity in such circumstances. It will take these societies time to overcome the dangers of extremism and the decline of values and standards, and to achieve stable economic development based on initiative and responsibility in accordance with moral and legal principles. Employment policies and the social cohesion strategy for eastern Europe have a crucial role to play in this respect.

For many years, a sizeable section of the population did not have to – and did not – develop the ability to adapt to a new, rapidly changing social and economic climate. The totalitarian society created and trained generations of passive, dependent people. A number of parallels may be identified in respect of variations in the number of disheartened people and the number of unemployed people, according to both the economic situation and especially changes in the rules governing the labour market, highlighting a process of convergence between these two groups and the emergence of a single category of jobless people working in certain areas of the unofficial economy.¹⁵ A section of the workforce has become disheartened during the transition years, resulting in a group of people who would in fact like to work but do not look for jobs because they do not believe they will find any.¹⁶

15. See Bogdanov, B., Chopov, D. and Michev, G. (2005) *The Bulgarian work force during the transition to a market economy*, Stopanstvo University Press.

16. The economic literature talks about residual unemployment. This involves a hard core of people unable to be hired, probably owing to their inability to fit into the current climate (*Guide to economic indices*, 2000, p. 93).

2. Labour flexibility or security at the cost of low wages and salaries

Full-time work is still the norm in Bulgaria, and part-time jobs are difficult to find, even for those wishing to do so. Those on genuine permanent employment contracts may be said to enjoy relative security. Wages and salaries are very low, however (the lowest among the 25-member-state European Union plus the accession countries)¹⁷. People have to pay a high price in return for a little security, it seems, and accept extended working hours or positions in more than one company.

At the same time, employment has become more flexible as a result of amendments to the labour code, including the introduction of new types of employment contracts and changes in respect of working hours, recruitment and dismissal procedures and labour mobility between sectors, occupations and regions, while the level of job security continues to fall. Labour legislation has been liberalised considerably in recent years, allowing a fairly high degree of flexibility. According to the debates taking place in Bulgaria, additional liberalisation would further reduce job security. Freeing up the labour market, liberalising labour legislation and making labour more flexible are the prime considerations; issues such as security and ways of including people with limited access to work are also being looked at, but to a much lesser extent.

The extended working day and week – which has become an ongoing and growing trend – and fixed-term contracts even for permanent employment severely restrict access to paid work for a number of population groups, who remain unemployed long term or become disheartened (young people, people over the age of 50, people with disabilities, single mothers, Roma and above all those with limited education and no specific occupation). Inequality and injustice are thereby becoming more entrenched, with increasing marginalisation and conflict as well as greater flexibility.

Private-sector employers wish to keep labour costs relatively low, prompting them to make use of the various forms of flexibility. Where possible, for example, they avoid hiring university graduates or older people. Nor do young people fit into their preferred hiring pool: they would rather

17 At the time when this text was written, Bulgaria and Romania were still not members of the European Union.

hire people aged 25 to 34.¹⁸ It is true to say that in fact they are not interested in people's skills or productivity. Their strategy is more one of short-term survival. They invest in skilled labour only where necessary. Low wages and salaries are all that count in their eyes, for their strategy revolves almost entirely around prices. Not only is this a short-term outlook economically, given that even lower wages and salaries will always be found somewhere in the world in the future, but, more seriously, it is the opposite of the "high road" on which the European social model is based. According to this business rationale, the aim is to get as much as possible out of one's employees, and the external social impact may be overlooked for quite some time. Yet there is more scope to reconcile economic and social needs and arrive at mutually beneficial arrangements as part of a "high road" strategy based on considerable added value, which makes judicious use of the available human capital. In this scenario, employees' well-being significantly enhances a company's performance, in turn benefiting its employees. On the other hand, the strategy most commonly adopted in Bulgaria – based exclusively on cheap labour – is another factor contributing to a downward spiral and pushing the country further away from social cohesion and economic competitiveness.

2.1. Employment contracts and working hours: less security and a lack of "empowering" flexibility

Most Bulgarian employees are subject to employment contracts; there are more female than male employees, and more people working in the public sector than the private sector.¹⁹ During the early transition years there was a strong tendency to limit the number of people hired on employment contracts; in the wake of amendments to the labour legislation under pressure from trade unions, however, the proportion of people working in conditions of relative security has increased in recent years (slightly more so for men than women).²⁰ The number of employees on civil contracts

18. "Working hours, working conditions and demographic behaviour", 2003 sociological paper, Centre for Population Studies, Bulgarian Academy of Sciences, Employment Agency, Ministry of Labour and Social Policy and the author (K. Vladimirova).

19. *Emploi et chômage/Employment and unemployment*, 2/2004, National Statistical Institute.

20. Under Bulgarian legislation, the following types of employment contract may be used: employment contracts (fixed-term and permanent); so-called civil contracts or contracts for specific assignments; other contracts and employment without a (written) contract. The latter three forms are considered more flexible, as they are more temporary and easier to break.

(contracts for specific assignments) is not very high, but this type of contract creates considerable insecurity. There are more men than women on such contracts, most of them working in the private sector.

Nevertheless, the number of employees without a contract, who face the greatest insecurity, remains relatively high. Indeed, they are not covered by the system of social security contributions, with all the ensuing short- and long-term consequences for themselves and their families.

Research on changes in working hours and conditions shows that fixed-term employment contracts are used mainly for younger, older and single people. They generate insecurity, with direct demographic implications in the case of young people, who will postpone, restrict or reverse their decisions about starting a family. Jobs for older workers are generally subject to fixed-term contracts, reflecting, on the one hand, the fact that it is impossible for working-age people to enjoy any kind of job security in the years before they are eligible to retire, and, on the other, the need to supplement low pension payments with employment.²¹ Those aged 51 to 60 are most likely to be on civil contracts, followed by those aged 41 to 50. In many cases it is their second or third employment contract, but for a significant number this is their only option if they are to work and receive an income, particularly those who have little education or have been made redundant. The majority of people declared as working without a contract are under 30 or over 60. According to research, fixed-term employment contracts – a less secure form of recruitment – are used for the least educated and the illiterate. With the level of education rising, the number of people on fixed-term contracts is decreasing.

Part-time work is rarely a choice, in which case it often supplements another wage or salary. It generally stems from a lack of other options for young people, women and above all the new generations. One fifth of young people (under the age of 30) stated that they had part-time jobs. Women in this situation are usually young, that is potentially fertile women or young mothers working part time. It is primarily men who deliberately choose part-time work, but generally as an additional job. For some senior citizens and young people, particularly the unskilled, part-time work is the only option.

21. In 2004, more than 5% of private-sector employees did not have a contract. See "Working hours, working conditions and demographic behaviour", 2003 sociological paper, Centre for Population Studies, Bulgarian Academy of Sciences, Employment Agency, Ministry of Labour and Social Policy.

Full-time work – which theoretically provides more security in terms of workplace, income and the job itself – has continued to play a dominant role in Bulgaria throughout the transition years. The number of people with access to paid employment, and thus to security, has dropped considerably, however.²²

The working day and week have officially – and even more so unofficially – been extended for most workers. This allows much longer working hours than those set by the legislature, and enables people to hold more than one contract. There is still considerable insecurity, however: it has been impossible for people to maintain their normal lifestyles, and in many cases even to pay their financial obligations and feed their families.

The extension of the working day and week has become an ongoing trend that is reducing the volume of demand for labour. Once again, it is vulnerable groups – such as young people, those over 50, people with disabilities, single mothers, Roma and above all those with limited education – who are seeing their chances of finding a job diminish even further. Inequality and injustice are thereby becoming more entrenched, with increasing marginalisation and conflict as well as greater flexibility.

The average working week is long (41 to 41.8 hours in 2004); there is little difference between the sexes, but private-sector employees work a slightly longer week. No major changes have been observed during the transition period. In practice, the average working week of part-time employees is approximately half as long (about 21 hours in 2004, without any gender disparity). Shorter working hours or working hours longer than the legally prescribed norm are found primarily in the private sector. The length of the working week is determined by the legislation in force and the associated implementing arrangements. A long working day and a six-day working week are standard practice. To a large extent, such working hours are not considered to constitute either extended hours or overtime. This situation,

22. In 2004, 96% of employees worked full time, and the gender disparity was insignificant (95.8% of men and 96.3% of women). The proportion of full-time employees has increased in recent years (8.9% between 2001 and 2004). The proportion of part-time employees is fairly low (just 1.8% of employees in 2004). The proportion of women in part-time work is slightly higher (2.2%). The majority of people working part time state that they do so because they cannot find a full-time job. Figures on the distribution of full- and part-time workers should be taken with some caution, as many respondents failed to indicate their working hours. These figures come from a representative national labour survey conducted quarterly in accordance with the relevant Eurostat requirements.

which seems paradoxical given that overtime was supposed to increase people's total income, may be ascribed to a sense of insecurity, prompting employees to accept such conditions; this is yet another illustration of the vicious circle at work. With wages and salaries generally paid monthly, it results in significantly lower hourly wages, not to mention other disadvantages: excessive workload, fatigue and an inability to recover.

Such working conditions are extremely problematic for women. Many of them face a dilemma: family or work, that is, poverty or overwork (paid work plus family duties), not to mention feelings of guilt about spending less time taking care of other family members, doing domestic chores and contributing to family-based production. Some women are overworked and do not have enough time – or, indeed, any time – to rest and undergo training, a situation that increases stress levels and the rate of occupational diseases. Exhaustion and the resulting state of health have an impact on the security and status of paid work. Moreover, the large amount of unpaid work they perform often limits their ability to retain paid work or to find a job. On the other hand, the fact that paid work is so insecure has forced people to develop home-based production, to work in the unofficial sector or to take more than one paid job. The case of women in particular shows that labour flexibility is desirable, but that it must be “empowering” in nature, enabling female employees to reconcile work and family life, for example. Yet the “low-profile” approach currently adopted in Bulgaria makes this kind of flexibility impossible.

2.2. Payment for work: flexibility or insecurity?

The government policy of limiting real wage and salary increases, and the gap between increases in labour productivity and increases in real wages, has helped to keep the cost of labour artificially low. This has not succeeded in balancing the market, probably owing to the lack of purchasing power and demand. It has reduced people's motivation to work and influenced their decisions about paid employment, work in more than one job and/or extended working hours or an extended working week. This trend is very marked among young people and unskilled workers; if the situation continues, it will raise the level of interest in welfare allowances and benefits, often to the detriment of employment and earned income. The low cost of labour does not encourage employers to make the best use of the human resources available to them or to grasp the opportunities offered by flexible forms of employment. None of this has a positive impact on labour market flexibility and economic efficiency.

The labour market, liberalised as a result of legislative reforms, has given employers greater latitude to respond to internal and external economic shocks by increasing labour flexibility, to the detriment of income and job security. In fact, employers have been able to survive in a climate of economic competition primarily because employers' contributions have been maintained at a relatively low level, limiting improvements in working conditions. At the same time, reduced demand for labour has made it difficult for trade unions to obtain significant compromises on flexibility and security by means of dialogue between management and labour.

While flexibility must be stepped up even further, what is needed is an "active" form of flexibility that also allows employees to flourish. There is potential for greater flexibility and more individualised remuneration packages, which in some cases would mean wages and salaries could be raised and flexibility tailored to individual circumstances. Yet, once again, the fact that trade unions are weak and employers in a difficult position makes such individualised labour relations a risky prospect. In practice, new staff remuneration systems and models are needed. Such models could incorporate a number of factors, such as the quantity and quality of work performed, working hours and individual productivity. Public acceptance is essential, as is the acceptance of certain values relating to solidarity and social cohesion.

Higher wages and salaries would encourage many of the "disheartened" to return to work, and the introduction of more flexible working arrangements would help another category of people currently outside the labour force – those looking after other family members, sick children and so on – to find jobs. Lowering income tax might also help to increase the level of secure, declared employment and people's real income and purchasing power.

3. Labour market and social cohesion policies

So-called passive policy measures prevailed during the early years of the transition to a market economy, such as the introduction and payment of welfare allowances and benefits for certain categories of unemployed people, incentives for early retirement and the withdrawal of a section of the working-age population from the labour market.

The situation has changed as a result of reforms aimed at establishing a viable market economy, and particularly preparations for European Union accession; labour market policies are starting to be overhauled,

with employment policy incorporating an increasing number of activation measures and programmes.

3.1. Active employment policy and measures to activate institutions and the unemployed

In the first few years, unemployment benefits were generous and based on pre-redundancy earnings. A more restrictive system was soon brought in, however.²³ Even tighter restrictions were introduced in subsequent years, designed to encourage the unemployed to return to work. Under the previous system, employers could cover workers by paying the minimum wage or slightly more, automatically conferring entitlement to minimum benefits.

This generous policy included a number of welfare allowances, mostly received by people who had not paid any contributions: young people registering as unemployed after completing their studies, long-term unemployed, unemployed people with young or dependent children, and so on. A specific act was passed to restrict and reduce welfare benefits. The aim is to encourage the unemployed to look for work.

The passive policy had a primarily social focus which formed part of the state's social policy; in a way, it was a continuation of pre-1989 policy. Such policies do not necessarily help to reduce unemployment, especially if they encourage the passivity long associated with state intervention. Aimed at reconciling labour flexibility and job security, such allowances are designed to give individuals greater autonomy and enable them to make the transition to another job with dignity. These policies must, however, be supplemented and adjusted to include active measures that help to build bridges with a view to successful transitions, especially for those who are in a difficult position within the labour market and cannot hope to earn more than the minimum wage. Such measures have become more prominent in recent years: employment policies now focus on ensuring that the state and local authorities do more to increase employment and, above all, reduce unemployment. A number of changes reflect the new strategy in respect

23. Under the 2001 Act on Unemployment Protection and Employment Incentives, the benefits received equated to 60% of gross pre-redundancy earnings (but could not amount to less than 80% or more than 150% of the country's minimum wage); the maximum duration was set according to length of service, but could not exceed twelve months. Under the latest amendments to the act, the maximum benefit entitlement is again equal to the minimum wage (in 2006).

to employment opportunities: there has been a shift from passive to active measures and from isolated measures and programmes to national employment action plans as part of the European employment strategy.

A major recent adjustment has been the introduction of subsidised (supported) employment, that is, the creation of supported jobs for the unemployed (known in Bulgaria as the secondary labour market).

3.2. Barriers to social cohesion resulting from public employment policy

The main policy priority is to increase employment by implementing active labour market measures designed to ensure the social and economic integration of people at an employment disadvantage, thereby overcoming social exclusion and improving their chances within the labour market.

It is hoped that these policies will increase the number of people hired and reduce overall unemployment. Nevertheless, the level and momentum of labour market recruitment are inadequate. The number and proportion of people eligible for the main labour market programmes are still low. Given the untapped potential of these measures and shortcomings in their implementation, they may have to be overhauled.

The various measures adopted and implemented in recent years as part of the active employment policy have focused on developing the secondary market (supported employment) rather than encouraging economic activity and investment with a view to creating jobs by means of economic growth. One of the weaknesses of such supported employment programmes is the fact that it is difficult for participants to move from temporary to permanent employment, that is, “steady jobs”. In their present form, therefore, such programmes cannot be said to be effective; their impact is primarily of a social, short-term nature (lasting a limited number of months while the programme is running).

The scope of active labour market policies remains limited. They are confined almost entirely to disadvantaged categories of unemployed people, and focus primarily on placing them in temporary jobs provided by a few specific programmes. A number of long-term unemployed people, generally uneducated and unskilled, find temporary jobs on basic wages in unattractive, badly paid and unsafe sectors demanding few skills. This is a key reason people refuse to take part in active policy programmes and withdraw from the official labour market, resulting in reduced activity among the working-age population. For part of this group, the alternatives

– namely welfare benefits or unofficial and even criminal activity – may seem preferable. Society is thereby divided into two categories: those with access to employment, income and economic resources, and those with very limited opportunities, who are pushed into exclusion, crime and migration.

A new income and employment policy must be introduced to improve the relationship between earned income and income from welfare benefits so as to promote employment. This will overcome the separation, anchored in practice, between an employment policy targeting those already in work or the more skilled unemployed, and active employment policies targeting vulnerable groups within the labour market. Such a separation exacerbates polarisation and fragmentation. The former take the most prestigious, most stable and best-paid jobs, leaving the others the low-paid, temporary jobs provided by active policy programmes, which do not require any skills or offer additional training.

If economic activity and employment are to be increased, social values surrounding work must be changed and people's ability to work enhanced by extending training, improving its quality, creating the necessary conditions for the social and economic integration of vulnerable groups, modifying official and unofficial employment arrangements and making greater use of the legislative framework as well as fiscal and financial mechanisms. Economic growth must focus on job creation and steady employment. Such an employment policy, aimed at long-term employment and social cohesion, should target both the unemployed and working-age people who are outside the labour force but wish to work. Total employment cannot rise significantly unless employment policy sets out to curb the unofficial economy, increase people's motivation to work and change the value system relating to work. This might help to ensure the implementation of a fairer social policy and to develop social cohesion within Bulgarian society.

4. Conclusions and recommendations for political action

It is obvious that the state of social cohesion in Bulgaria is not as good as it could be. A recent illustration of social fragmentation is afforded by the emergence of an extremist party taking a populist line that makes a scapegoat of certain ethnic groups – such as Roma – and enjoys considerable popularity among some sectors of the population.

The injudicious, excessive use of labour flexibility is partly responsible for creating insecurity and contributing to a situation that is something of a

downward spiral: economic problems, flexibilisation and exploitation of labour, stress, demotivation, loss of professional and social identity, limited investment in human capital, reduced employability, lost productivity, distrust, social exclusion, crime and so on.

The country needs to embark on an upward spiral, in which flexibility and security reinforce one another. Such a context provides scope for reconciling flexibility and social cohesion.

The problem is that once a country has entered a vicious circle – a term that may be used to describe many aspects of the Bulgarian situation – it is difficult to know where to start in order to escape it. As explained above, steps must be taken to introduce an “empowering” form of flexibility, to spread work out more, to bring the different sides together with a view to genuine dialogue between management and labour and to make the best possible use of the human capital available, all at the same time. If each aspect is looked at in isolation, however, the only apparent solution is one of downward levelling. Yet in the final analysis what everyone – business and citizens – wants is a positive outcome. In addition, the concept of social cohesion has a negative connotation in central and east European countries, of which Bulgaria is one, for it recalls the socialist system of old. What is needed, therefore, is an inclusive strategy that looks at the issue of social cohesion as a whole and addresses all of these aspects at once. A long-term strategy must be adopted. Given the nature of “path dependency”, however, it would be inappropriate to wait for the economic situation to improve before attempting to resolve the country’s social problems.

Ways of increasing economic activity and employment with a view to enabling marginalised groups to re-enter the labour market ought to be envisaged in conjunction with the introduction of flexible forms of employment, including part-time work. Access to the labour market and various forms of employment calls for changes in the education and training policies pursued by the education system and employment services, so as to ensure that unemployed and disheartened people are more adaptable in the employment arena and better prepared for the development and demands of the business sector.

With a view to raising the level of employment among older people (over the age of 40 or 50) both the public-sector and private companies must introduce employment policies involving a combination of flexible working hours and training. Such a policy is also necessary for young mothers and women returning to work after an extended break or time off to care

for a relative. Ageing societies such as Bulgaria's need labour flexibility in order to reconcile working and family life. The labour market must be made more flexible for business by means of more flexible recruitment procedures, remuneration packages and working hours, the introduction of atypical forms of employment and the promotion of flexible organisation of labour.

In order to increase people's motivation to work, the right balance needs to be struck between the minimum wage and the level of welfare benefits and allowances: this will encourage the unemployed and disheartened to find work. Accordingly, changes must be made to the income policy over the next few years and, above all, the ratio of earned income to income derived from the various welfare benefits must be improved. The development of labour market and employment flexibility makes such a policy all the more necessary.

With a view to making the most of flexible forms of employment, it is important to find additional ways of facilitating access to the system of welfare benefits and allowances for part-time workers, so that they can support themselves and their families from the income they earn and the welfare benefits and allowances they receive. This will enable them to look for paid work; once employed, they will rely on their jobs rather than on income supplements and welfare benefits. To this end, it is very important to introduce and maintain welfare benefits at a level that enables "poor workers" to cover their basic needs, but also to ensure some degree of "discomfort" for such workers so that they try to increase their income.

Employment policies include measures and programmes targeting unemployed young people. These cannot resolve the problems of emigration and the "brain drain", however. A different type of employment policy is needed: one based on skilled jobs and new technologies, which leads to a different standard of living, helps young people to find work and ensures their adherence to the values of social cohesion.

There is scope for increasing employment by adjusting working hours and the length of people's working lives; these options have not yet been tried. The existing legislative framework and, above all, the social practice of long working days and weeks, overtime and second jobs reduce the already limited employment opportunities. This would also enhance social cohesion and solidarity between different sectors of the population.

In recent years, Bulgaria has had a clearly stated policy of lowering the cost of labour to business, resulting in a number of areas of conflict between

employees and the unemployed, young people and older workers, workers subject to different working conditions, those with and without social security coverage and between wage and salary earners and the recipients of welfare benefits and allowances. Together with impoverishment, these conflicts are exacerbating insecurity and destroying the fragile solidarity within Bulgarian society.

Such a strategy – based solely on low wages and salaries and conflicts between employees – is not adequate, however, to ensure either social cohesion or long-term economic development. Bulgaria must try to take the “high road” and attempt to break the cycle leading to downward levelling. In conjunction with efforts to stamp out undeclared labour, it needs a social cohesion strategy that strengthens the social dimension. With such a strategy, labour flexibility and social cohesion go hand in hand.

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IV – Labour market flexibility and security – The Russian way

Vladimir Gimpelson, Director of the Centre for Labour Market Studies at the Higher School of Economics, Moscow (Russian Federation)

Introduction

The mix of flexibility and security is just one of many dimensions that distinguish labour markets in cross-country comparisons.¹ This mix is strongly embedded in institutions and may assume an implicit reconciliation between flexibility and security. Any attempt to shift the balance that exists between these two aspects often faces strong political resistance since this would affect institutional equilibrium and cause redistributive consequences. In this context, the case of transition economies is of special interest since institutional changes associated with transition are far from over.

The focus of this paper is the Russia Federation. In his paper on Russian employment and unemployment, written in the mid-1990s, the leading British economist, Richard Layard, coined the term “the Russian way in labour market adjustment”. This was meant to pinpoint specificities of the Russian model versus more standard adjustment patterns. Since then much has changed in Russia but the labour market has not left this path. The major distinction here is that wages are very flexible while employment is rigid, and this combination is contrary to economics textbooks. This model therefore consists of a non-conventional – reversed – mix of flexibility and security.

The institutional core of this model is a “cocktail” containing very rigid formal rules, as they are fixed in labour legislation, poor law and contract enforcement, and the wage-setting machinery linking individual wages to the company’s financial performance. This type of labour market absorbs external shocks by extreme downward wage flexibility, and hence reduces employment and unemployment fluctuations. Each of the three macroeconomic crises in Russia throughout the 1990s (1992, 1994 and

1. Freeman, R. (1998) “War of the models: which labour market institutions for the 21st century?”, *Labour Economics*, No. 5, pp. 1-24.

1998) cut a big slice out of the average worker's real wage while hardly affecting the aggregate employment. Russia has come out of this turbulent period as a surprisingly good performer in employment and unemployment.

This perspective of the "Russian model" may explain various dimensions of labour market and social policy development, including high inequality and proliferation of poverty among the working population. In the "standard" labour market case, the likelihood of being in poverty is higher for long-term unemployed, low skilled and poorly educated individuals. In contrast, the Russian model engenders poverty among the most educated part of the labour force, including teachers, medical doctors and scientists. This paper seeks to demonstrate that stimulating inequality and individual adjustment destroys cohesion and solidarity in the society. Neither the recent economic growth, nor the new labour legislation enacted in 2002 has changed the systemic core of the Russian model in labour-market adjustment.

This paper is structured in the following way. The first section discusses some quantitative measures and properties of Russian labour market flexibility. The second section presents the regulative framework explaining normative rigidities in the labour market. The third section tries to explain the large gap between the actual performance and normative framework. The fourth sums up with a tentative gains vs losses balance sheet for this style of flexibility. The paper concludes with policy recommendations.

1. Labour market adjustment: "the Russian way"

We can start the discussion by looking at how the Russian labour market has evolved from the turmoil of the earlier 1990s throughout the transition.²

The complete story of labour market adjustment since the early 1990s can be divided into two distinct phases. During the first phase, which lasted until the end of 1998, the deepest transformational recession brought the aggregate GDP down by 40%. The labour market reacted to this fall with only a slight reduction in employment (14% less employment with a 40% fall in GDP). The increase in open unemployment was modest, but

2. Gimpelson, V. and Lippoldt, D. (2001), *The Russian labour market: between transition and turmoil*, and Kapeliushnikov, R. (2001) *The Russian labour market: adjustment without restructuring*, Moscow.

both working hours and real wages were significantly reduced. During the second phase (since 1999) the economy entered post-transformation recovery growth. By 2006, the GDP had grown by almost 50%, to the 1998 level. Most of the key labour market indicators reacted rather positively while real wage increase was rapid and impressive in its magnitude.

These unconventional properties of labour market adjustment in Russia (and the Commonwealth of Independent States (CIS) countries in general) are in sharp contrast to those observed in the central and eastern European or the Baltic countries.³ The labour market in the latter countries has behaved more or less conventionally, although with some regional variation. That is, the employment side usually takes the brunt of adjustment while wages do not. In Russia and the CIS countries, flexible wages exist against a backdrop of inflexible and robust employment trends.

Let us take a short trip through the major dimensions of the labour market adjustment in Russia.

The economic activity of the Russian population has remained high. The participation rate (in Russia, it is conventionally measured for 15-72 year olds) decreased from 70.3% in 1992 to 61.1% in 1998, but then it went up again to 66% in 2002-03 following the wage recovery in the post-crisis period. Cumulatively, the decline in participation over the whole period was less than five percentage points and had no gender-specific bias. For women, the magnitude of the decline was the same as for men. Despite the deep economic recession, Russia managed to avoid large-scale outflow from the labour market, as was the case in some CEE countries (for example, in Hungary). If recalculated for the more conventional ages of 15 to 64, the participation rate in Russia is 70% and can be considered one of the highest among all transition economies. If recalculated given the legislated retirement age of 55 to 60, the labour force participation becomes one of the highest in the world.

The employment/population ratio (the employment rate or e/p ratio) in Russia has also remained stable and has been rather resistant to multiple exogenous demand shocks. Throughout the reform period, the aggregate decline in the employment rate has never exceeded 15% (compared to the initial pre-transition level) and has obviously been disproportionately small given the almost halved GDP. The e/p ratio is currently at about 65% for

3. See Rutkovsky, J. and Scarpetta, S. (2005) "Enhancing job opportunities. Eastern Europe and Central Asia", The World Bank, Washington, DC.

the population as a whole and stands at around 70% for the working-age population (age group 15-64). This is a surprising performance, since in most of the central and eastern European countries employment followed closely the GDP trend. It fell when the latter fell and then stabilised when the GDP started to grow again. An obvious divergence between the evolution of the GDP and that of employment testifies to a sharp drop in productivity in the first half of the 1990s. Most of the central and eastern European countries have avoided that.

The economic recovery following the 1998 financial crisis brought a resumption in employment growth. Various estimates suggest an increase in the aggregate employment with the magnitude of 3 to 5 million persons. Most of these jobs have been created in the service sector, including small firms, non-corporate entrepreneurship and self-employment. Therefore, the Russian economy in general did not experience the “jobless growth” typical of many central and eastern European countries, however, the corporate sector largely did. Large- and medium-sized firms lost 2 to 3 million jobs while small non-incorporated businesses and self-employment gained. These gains offset the corporate losses and drove total employment up. Significant leads in GDP growth rates over employment growth rates resulted in rapidly growing productivity during the recovery period.

Given the unprecedented scale of the transitional recession in Russia, one could expect to see this country as a “leader” in unemployment. The combination of an initially high proportion of industrial employment and a relatively small rural population increased the likelihood of this scenario.⁴ However, neither at the earlier stage of the market transition, nor at its later stage did we witness any explosion of joblessness. In this sense, the market response has also been atypical.

Russian unemployment growth has been gradual and stretched over a rather long time period. It took five years of market reforms and a drop in GDP of 40% for the rate of unemployment to exceed 10% of the labour force. The maximum point of around 14% of the labour force in unemployment was reached at the beginning of 1999, or in the eighth consecutive year of the transition. Since then unemployment has been on a gradual downward trend and is now steadily under 8% of the labour force. Such an outcome can be considered a very good performance, if other things, such as wage flexibility, are not taken into account.

4. Subsistence agriculture can absorb labour slack from the downsizing of overmanned industries.

There are several reasons to make us to think that the evolution of unemployment looks atypical if compared to other transition countries: a. the unemployment trend was gradual without any steep fluctuation caused by mass lay-offs; b. its rate never reached peak levels typical for other post-socialist countries; c. it decreased faster than in other transition economies when the economic recovery began; d. the current (LFS based) rate (around 7.5% of the labour force) makes Russia one of the best performing transition economies; the registered unemployment is almost negligible with 2% of the labour force; e. long-term unemployment is smaller in size and shorter in duration than in the central and eastern European countries.

In Poland, which is usually considered one of the best economic performers in the central and eastern European region, unemployment is close to 20%. Slovakia and Bulgaria are also close to this level. Alternative labour market indicators confirm this picture. The long-term unemployed account for a third of all unemployed in Russia, while in the majority of the central and eastern European countries long-time job-seekers make up over half of the unemployed population. Consequently, Russia now enjoys a long-term unemployment rate of 2.7%, which is also one of the lowest among all the transition economies.

Atypical adjustment has also manifested itself in the flexibility of working hours throughout the period. In the first half of the 1990s, the average annual number of working days in industry decreased by nearly a month. Since the mid-1990s, the number of annual average working hours per worker in the Russian economy has somewhat increased, but they are still shorter than before the start of the reforms. This hints to the fact that quasi-fixed costs seem to be lower than firing costs. In the CEE countries in contrast, working-time figures have been relatively stable as compared with the pre-reform period.

There is also a remarkable variation across employees in actual working hours. They have reacted flexibly to fluctuations in labour demand, thereby easing the adjustment. About 15% to 20% of all employees work longer hours than the weekly forty-hour standard.

However, the most peculiar feature of the Russian labour market model concerns wage behaviour. The observed magnitude of wage fluctuations within short-term periods seems to be unprecedented. This flexibility has emerged as the opposite side of employment rigidity. Wages proved to be flexible at macroeconomic as well as micro-level, thereby violating economists' standard belief in their downward rigidity. During

the 1990s, the average worker's wage lost two thirds of its real value. This "loss making" was not gradual over time but strongly concentrated around three particular episodes associated with major macro-shocks. The price liberalisation in January 1992 cut real wages by one third, the financial crisis of October 1994 took away approximately one fourth and finally the financial crisis of August 1998 devalued real wages by over 30% once again.

This wage flexibility was further enhanced by the extensive use of wage arrears in the 1990s and various forms of informal, off-the-book payments throughout the period. The concealed part of the total labour remuneration was typically the first to react to any changes in the economic situation. Such large-scale wage adjustment allowed for overcompensation of the pre-shock rise in total labour costs and it also eased pressure on employment. Each shock was followed by an immediate and partial wage recovery. In 1999-2005, annual real wage growth reached double-digit figures and, as a result, real earnings nearly doubled.

Figure 1 – Monthly dynamics of employment and real wages in Russia (1991-2002, January 1991 = 100%)

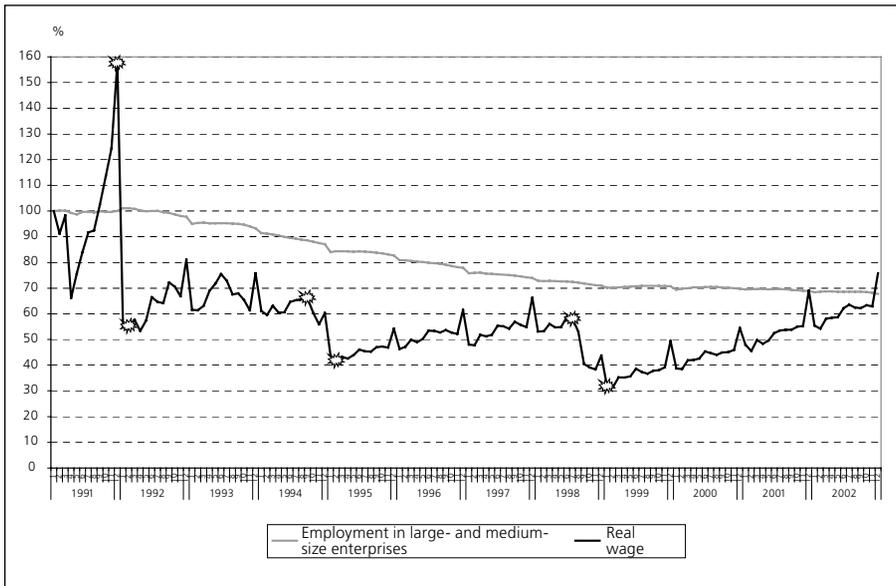


Figure 1 illustrates the dynamics of employment and wages throughout the period under consideration. One can clearly see how insensitive and inert employment is as well as how flexibly wages react.

In all the former socialist countries, systemic change has brought a rise in earnings inequality. In Russia, this increase was exceptionally large. The Gini coefficient jumped from 0.32 in 1991 to the level of 0.40 to 0.45 within the decade. This suggests significant flexibility in relative wages and the link between earnings inequality and wage-setting rules (discussed below).

However, a considerable proportion of the inequality is a result of the size of the Russian territory and of the enormous diversity in economic structures across the country. The inter-regional component of the inequality explains around one fifth of total inequality. In fact, most of the intraregional Gini coefficients for earnings are much smaller and are similar to the central and eastern European estimates. The notable exceptions are oil- and gas-extracting regions in the Siberian part of the country, which are much less equal. However, no one could expect raw-materials extracting economies to generate low-inequality wage distribution.

Throughout the transitional period, the Russian economy experienced an intensive labour turnover. If defined as the sum of hirings and separation rates, it reached 43% to 55% for the entire population of large and medium-sized companies and 45% to 60% for the industrial sector. These turnover rates were noticeably higher than in the majority of the central and eastern European countries. Remarkably, lay-offs played a minor role and new hirings remained buoyant throughout the period. Even in the most critical years, the hiring rate in Russia was steadily high, which suggests that employers were quite confident in their ability to contain labour costs, if necessary.

The domination of voluntary resignations in the structure of labour turnover looks no less paradoxical, while involuntary separations contribute very little to the total turnover. Lay-offs accounted for a mere 1% to 2.5% of the workforce, or 4% to 10% of the total separation rate. Meanwhile, (voluntary) quitting rates reached 16% to 20% of the workforce, or 65% to 74% of total separations. Even admitting that a certain proportion of lay-offs was disguised as voluntary resignations does not significantly change the major conclusion. Still, it is hard to believe that the majority of resignations are hidden lay-offs.

High rates of labour turnover resulted in a proliferation of short job tenures and a high proportion of short-tenured workers on the Russian labour market. The average tenure in the late 1990s was under nine years and the proportion of workers with the tenure under one year was 17% of all employees. This induced H. Lehmann and J. Wadsworth to entitle their

paper on job tenures in Russia as “Job tenures that shook the world”. Both indicators (average tenure and percentage of short-tenured workers) clearly differentiate Russia from other central and eastern European economies and tend to confirm the status of Russia as a high mobility country.

High labour turnover was associated with large-scale cross-sectoral reallocation of employment. If in the early 1990s the service sector accounted for about 40% of all jobs in the economy, this proportion reached 60% within ten years. This 20% structural shift caused massive occupational change and was called “the great human capital reallocation”.⁵ According to Sabirianova, 42% of all employees changed their occupation in the period between 1991 and 1998, and two thirds of them did so at the initial stage of the reform period in 1991-95. This may mirror the fact that the Russian population enjoys a significant reserve of general human capital, while the skill-specific component of this human capital has become obsolete or strongly depreciated. Mass labour reallocation supports the point that the Russian labour market allows for remarkable external flexibility.

The wide use of a variety of “non-standard” forms of employment reflects another dimension of labour market flexibility. This relates to both external and internal flexibility as well as the trade-off of quality of employment for job security.

One usually understands various forms of employment on either part-time or short-term labour contracts as non-standard. Self-employment, contracting with temporary work agencies (TWAs) various types of individual subcontracting or combinations of all the aforementioned also belong to the category of non-standard employment. Additionally, in the 1990s Russian employers widely used other non-standard forms of labour and pay, such as forced part-time work and administrative leaves, wage arrears and pay-in-kind arrangements. They were not explicitly legislated but spontaneously emerged as a result of non-enforcement of the rigid regulations.

In a few years nearly a quarter of the personnel of large and medium-scale companies worked shorter hours or were on administrative leave. Informal (undeclared and not taxed) payments made up to 50% of official remuneration. At some points, wage arrears affected almost three quarters of the country’s working population. Though use of various “non-standard”

5. Sabirianova, K.Z. (2002) “The great human capital reallocation: a study of occupational mobility in transitional Russia”, *Journal of Comparative Economics*, Vol. 30(1), pp. 191-217.

forms of adjustment has become much more rare since the beginning of the recovery period (for example, the rate of involuntary part-time employment has dropped to below 1%), they are still used and concern a non-negligible part of Russia's labour force.

Most of the "non-standard" adjustment mechanisms have one important feature in common. They are informal or semiformal, thus allowing the parties to bypass employment protection and to replace formal labour contracts by informal relations. Taken altogether, non-standard employment has significantly contributed to the adjustment of labour costs in hard times.

To sum up, the Russian labour market was characterised by relatively stable employment and moderate unemployment; flexible working time and super-flexible earnings; intensive labour turnover as well as a high incidence and variability of "non-standard" labour relations. In consequence, it proved itself able to absorb the numerous negative shocks that accompanied the systemic transformation.

2. Labour market flexibility: the normative framework

From the description presented above one may conclude that this particular labour market hardly has any regulations. However, this conclusion would be a wrong one. Moreover, a closer look at the legislative framework within which the Russian labour market operates unveils a completely opposite picture. The Russian labour market emerges as one of the most regulated markets in the modern world. These regulations are restrictive in all major components and, if strictly enforced, allow little space for any flexibility.

From an institutional standpoint, the scope for flexibility is largely determined by the employment protection legislation (EPL). The code of laws on labour (KZOT) that was in force in Russia throughout the 1990s was adopted during the Soviet times (1971) and, with multiple partial amendments, was used until 2002. It was developed in the context of the central planning system and consequently had little to do with the market economy.

The KZOT strongly required employers to hire employees on standard open-ended contracts with a full-time working week. It provided a very high level of formal employment protection for regular workers. Under the law, the trade unions enjoyed veto power on any lay-offs due to economic reasons. Even if the trade union did not object to laying off

redundant personnel, firing costs incurred by employers were prohibitively high. The law stipulated two months of advance notice to trade unions and local authorities and severance pay equal to three months' average wages regardless of actual job tenure. In the case of employees working in the northern part of the country (around 10% of total employment) the total severance pay could reach up to five months' average wages. For core workers, the total duration of advance notice and severance pay could be up to eight months.

The KZOT put serious constraints on the use of non-standard labour contracts, for example fixed-term contracts were allowed in exceptional cases only. Overtime was formally permitted but with the duration strictly limited to 120 hours per year. Additionally, the labour legislation was overloaded with various requirements of social benefits and guarantees, which were to be funded by employers. Multiple amendments to the labour code that were introduced during the 1990s did not change the principal nature of the legislation. It remained very rigid, but full of internal contradictions.

The new labour code, adopted by the legislature in 2001, came into effect in early 2002. Though many contradictory and obsolete requirements were abolished, the EPL part of the code changed very little. Having emerged as a political compromise, it basically inherited all the major rigidities of the old KZOT. Unsurprisingly, the labour code contains norms reflecting realities of the market economy while preserving constraints inherited from the Soviet past.⁶ This conclusion relates to the labour legislation, in general, and to the EPL component, in particular.

Firing costs remain as prohibitive as they always have been, while the use of temporary contracts is still over-regulated. The labour code includes a closed list of reasons in which temporary contracts are allowed. In spring 2004, the Supreme Court of the Russian Federation issued special directives ruling against a more liberal interpretation of this part of the labour code and calling for a more restrictive use of temporary contracts. Fixed-term contracts, if signed illegitimately, must be treated as open-ended. Courts usually judge all labour-contract related cases in favour of employees.

6. A major positive change was the abolition of trade unions' veto power on mass layoffs.

In 2002-03, we surveyed 900 industrial firms in order to understand the employers' attitudes to the changes brought by the new EPL. The major conclusion was that business managers did not see any significant impact from the EPL change on the firms' labour market behaviour.

A high unionisation rate, centralised bargaining and a significant tax wedge all add to the likelihood of labour market rigidity as it should emerge from the formal institutions. We can put the Russian EPL in the cross-country comparative context using a family of integral indices of EPL stringency. Such indices designed by various international economic organisations (the World Bank, the OECD, the ILO) differ in methodology and vary in coverage of countries. However, they all unambiguously point to the fact that the formal labour market regulations in Russia are among the most rigid in the world.

On the World Bank (2003) EPL scale, Russia has a score of 61 as opposed to the average score of 45 for the OECD countries. The higher score means a more protective and rigid labour market. If only regulations on firing are considered, the Russia-OECD gap becomes even larger with the Russian score of 71 compared to the average of 28.

The OECD EPL scale scores Russia at 3.2 in comparison with 2.0 for the OECD countries on average, 2.4 for the older European Community countries and 2.5 for the transition economies.⁷ These estimates refer to the year 1999 and do not account for changes in the labour legislation, which were later introduced in Russia, Poland, and Slovenia. But if in the two latter cases the EPL was softened significantly, the new labour code in Russia changed the country standing on the general EPL scale very little. This means that the gap between Russia and other transition countries in this respect should grow even further. It would be fair to reiterate here that a flexible labour market is among the most important factors shaping a favourable investment climate.

3. Why do normative and actual patterns differ?

As we can see, the actual flexibility pattern contrasts strongly with the normative framework. This raises the question of how to reconcile these two markedly different pictures. How can the labour market perform as flexibly as it does if all the labour market regulations are as rigid as they look?

7. Cazes, S. and Nesporova, A. (2003) "Balancing flexibility and security in central and eastern Europe", ILO, Geneva, p. 100. See also "Employment outlook for Russia", Vol. 1 (1991-2000), Appendix 3.

The answer seems quite obvious. These regulations are poorly enforced and employers and employees do not consider formal norms as credible and binding. In the 1990s, the Russian Government was not only unable to enforce labour laws, but was itself the first to violate them. This transformed constraints and incentives for all labour market agents.⁸ The recent World Bank study underlines that the labour market flexibility in the CIS countries comes basically from the “flexible” enforcement of stringent EPL rules.⁹

This part of the story goes, however, far beyond simple non-enforcement. The actual “rule of law” is selective and varies across regions, sectors, old and new firms and also across various segments of the EPL.¹⁰ In large and unionised firms (making up roughly two thirds of total employment in Russia) the EPL is enforced relatively well but in small firms it hardly holds at all. Instead of reducing uncertainty, the EPL (through non-enforcement) increases it and differentiates firms in their mandatory labour costs. Firms that enjoy discretion in applying the EPL may deprive some workers of social protections. Those that follow the rules avoid creating new jobs and keep a policy of low wages. Formally law-abiding large and medium-sized firms often use small firms as flexible suppliers of labour.

This selective flexibility is reflected in aggregate employment dynamics and employment-to-output elasticity for the period 1999-2005 (or for the post-1998 crisis period). Since 1999, the aggregate GDP has grown by around 50% while the total employment figure has added around 9% or 5 million workers. Meanwhile, the regulated segment of large- and medium-sized firms (the main driving force in the GDP recovery) has lost 2 to 3 million jobs. This means that the response of employment to output growth was negative in this segment, while actual employment growth (compensating for the loss of corporate jobs) took place outside the regulated segment.

This perverted flexibility has also been facilitated by specific public- and private-sector wage-setting institutions and policies. The standard case assumes that the ongoing market wage reflects marginal productivity of labour and depends on the worker’s human capital. The prevailing wage

8. Gimpelson, V. (2001) “The politics of the labor market adjustment (the case of Russia)”, in Kornai, J., Haggard, S. and Kaufman, R. (2001) *Reforming the state: fiscal and welfare reform in post-socialist countries*, Cambridge University Press.

9. Rutkovsky, J. and Scarpetta, S., op. cit.

10. For example, the lay-off-related regulations are enforced better than the regulations on overtime work.

principle links salaries of public-sector employees to those in the private sector. While wages are usually downward robust and somewhat sensitive to exogenous shocks, in Russia, they are not sticky at all when facing shocks and react flexibly to any fluctuations in financial performance.

Let us start with wage setting in the private sector. In the Russian case, the wage-setting machinery allows individual wages to fluctuate significantly. One of the major reasons for this is their linkage to the financial performance of firms. The basic (tariff) part of individual wages, which is in fact downward rigid, makes up on average about half of the total, while the rest of the pay constitutes a kind of bonus or wage premium that indirectly reflects the firm's financial performance. Since performance varies over time (and across firms) and the employment is sticky due to inertia, the wage premium can grow in good times (and in good firms) and shrink in bad times (and in bad firms). In the best performing companies, the wage premium component may be a multiple of the basic (tariff) component. Moreover, allocation of these wage gains across workers does not reflect only relative differences in their human capital but largely mirrors differences in workers' individual bargaining positions. Meanwhile, workers' bargaining power comes from multiple sources, including their firm-specific skills, demand and supply factors, other job opportunities, some social considerations, informal relations, etc. All this generates not only remarkable wage flexibility but significant intra-firm inequality as well.

As it should be said here, firms are absolutely free in selecting a wage-setting system. However, many firms in the old corporate sector use a kind of tariff scale, which is implicitly linked to the national minimum wage. Minimum wage defines a lower boundary for any tariff scale but the latter may be much higher than the minimum wage itself. Since the national minimum wage is set at a low level, the rigid part of the total individual wage is relatively small while the flexible or variable part is, on the contrary, quite large and depends on the firm's financial performance.

Private-sector and public-sector labour markets interact and affect each other. Now let us take a look at the public sector, which is still pretty large in Russia. The public sector has particularly large employment in education, health care and public administration. So does that mean that the government is the ultimate wage setter in the public sector? Does public-sector wage setting affect private-sector wage setting, and if so how? What are the implications for labour market flexibility?

Public-sector pay is based on the so-called Uniform Tariff Scale (UTS) directly linked to the minimum wage. Public entities (public schools, hospitals,

museums, research institutions, etc.) receive mandatory budgetary funds based on the UTS system. The UTS provides the lower boundary for pay, but does not exclude any upward salary adjustments if additional funds allow. Any additional – non-budgetary – funds, if available, can be translated into further salary increases. Access to additional resources is not evenly distributed across public-sector entities and is much better in large cities and economically well-off regions. In addition, many are engaged in commercial activities, proceedings from which can be used for funding wage premiums. How this premium is distributed across entities and within entities results from decentralised decisions in regions and in particular entities. In summary, resulting wage differentiation comes from several sources: UTS-based wage setting, regional and municipal specific funds, entity-specific funds and the individual's bargaining position. Salary for a particular public-sector worker emerges as a multilayer pie, in which only the UTS-based part is centrally fixed. This partially explains the significant wage differentiation even within the publicly funded sector.

As an illustration we can cite results from our survey of 400 secondary public schools conducted by the Centre for Labour Market Studies in 2004. Public schools are homogeneous in that they are subject to the same uniform regulations and the same wage grid. However, the maximum average wage is four times that of the minimum average wage (in the surveyed schools), while all six regions in the sample are in the middle of the distribution and are not among the most affluent or depressed territories. Simple econometric exercises show that being in a particular region is the most important factor in determining wage level in a school since it reflects the regional fiscal position. The maximum average wage in the educational (predominantly public) sector between regions can reach up to five times that of the minimum average wage. The same wage differentiation is observed for other public-sector economic activities. This also questions the tentative argument that the wage system is strongly centralised.

The legislatively set minimum wage and the Uniform Tariff Scale are not differentiated across regions, despite the enormous inter-regional heterogeneity. Having regionalised minimum wages would probably increase wage differentials in the public sector. But even the uniform minimum wage does not bring all regions to the same actual wage level. Since setting of the minimum wage level should take account of regional labour market conditions, so as not to disadvantage critically laggard territories, the minimum is usually set at the level that is affordable for the most depressed regions. For all others regions (which are relatively better off)

this level appears to be too low for any upward spill-over effects. The contrary is more likely. Higher alternative private-sector wages may drive the public-sector wage upward while regional budgets are forced to accommodate this additional demand as much as they can. As a result, public-sector entities differ in terms of wages actually paid and in the proportion of salary determined by the centralised UTS.

In Russia (as well as in other CIS countries), public-sector pay is much lower than that in the private sector. Low relative wages in the public sector can hardly have a disemployment effect but may lead to the expansion of low-wage jobs in the private sector. There is a strong empirical regularity that public-sector employment across Russia is negatively correlated with the per capita GDP and the regional fiscal position. The most depressed regions have a very large chunk of employment in public education, health care, etc. In some regions, educational institutions make up 20% of total employment. This turns the public sector into the major employer and the principal wage setter in some regions. In this sense, private-sector firms are “wage-takers” with downward directed pressure. Therefore, the public sector “works” as a wage anchor contributing to general earnings inequality.

One of the questions that may arise here concerns the role of trade unions in this wage setting as well as EPL enforcement. At this point in the story, one may assume that we are discussing an economy where there are hardly any trade unions. Again, formally, this is not the case since the old corporate sector and the public sector have very high unionisation rates and quite high coverage by collective agreements. Nevertheless, these agreements are in reality not binding and have the same enforcement problem as the EPL. This makes the collective voice barely heard while workers are left with only individual voices and exit options.

The high flexibility and adaptability of the Russian labour market are certainly provided by non-enforcement rather than by flexible institutions, and in particular wage-setting institutions, acting across the economy.

4. What are the major implications for social protection and social cohesion?

What is the resulting pay-off generated by this model? What are the ultimate gains and losses produced by this type of labour flexibility? What are particular implications for social security and social cohesion? Based on the discussion presented above we come up with the following balance sheet.

Clearly, this is a very approximate list of outcomes and much remains to be explored.

On the positive side, the labour market performs unexpectedly well if judged by the major quantitative employment and unemployment indicators. These gains are largely short or medium term.

Russian-style flexibility helped to weather the storm of the early transition and to avoid mass unemployment. It allowed for the maintenance of high employment and participation rates while unemployment never approached any dramatic levels. This had both economic and social advantages. From the macroeconomic point of view, this helped to ease fiscal pressure; from the social perspective, this stretched adjustment time for individuals and households, and allowed them to avoid joblessness, to retain social ties, guarantee minimal income, etc.

On the negative side, there are multiple losses, including in the medium and long terms. "Russian style" labour market flexibility does not stimulate economic growth and does not facilitate company restructuring. It saves old jobs at the cost of creating new jobs. It engenders poverty, generates inequality among the employed and educated, deprives people of formal and institutional social protection and destroys social cohesion in the society.

The major price paid for maintaining a high level of employment is in low average wages. Keeping low-wage employment works as a device that protects formal employment and substitutes formal unemployment benefits. Low-wage jobs can be supported by moonlighting activities and engagement into low-productivity employment in the informal sector. All this leads to inefficient utilisation of human capital.

Low transparency in the labour market and strong asymmetry in information on job vacancies and individual productivity turns this information from a public into a private good. When searching for a job or entering paid employment in this type of labour market, an individual faces high uncertainty since he or she cannot foresee future earnings. This increases individual search and adjustment costs, including moral costs associated with search behaviour; generates voluminous and inefficient churning (short-term job matches) and negatively affects the efficiency of labour reallocation.

This type of flexibility devalues formal contracts, which are crucial for the modern economy. This devaluation destroys trust and creates strong disincentives for investments into specific human capital. Instead of

investing in specific human capital, employers prefer to hire job candidates with better general skills, which are often considered the only reliable labour market signal. This, in turn, creates wrong incentives for the education system. Linking wages to financial performance and individual bargaining power stimulates significant earnings inequality. It clearly rewards individual adjustment and lowers the need for collective actions, leads to segmentation and atomisation of individuals and destroys values of solidarity and cohesion. Low tenures and high turnover lead to the destruction of social cohesion and low solidarity.

This model is inappropriate for achieving economic efficiency as well as for providing social cohesion. It impedes job creation in the formal sector and preserves obsolete and low-productivity, low-wage jobs. The final balance sheet suggests that the partial positive implications of the model have already been exhausted, or are close to exhaustion, while the negative ones will last into the future as well. This means that the acting model has to be replaced or radically reformatted, which assumes a strong demand for comprehensive labour-market reform. Such reform is unlikely to be popular and cannot be adopted in a shock therapy style, but requires politicians to have a strategic vision and long-term objectives.

5. Conclusions: major policy implications

The institutional equilibrium shaping “Russian style” labour market flexibility is contradictory to both economic growth and social cohesion. It allocates major outcomes of the growth with significant social costs. I believe that the institutional framework supporting this style of flexibility deserves a radical reshaping despite all political costs and risks associated with this reform.

Clearly, much that has to be done is outside the labour market per se. First of all, economic growth and restructuring of the economy would facilitate this type of reform and these are conditional upon a wide set of policies and particular measures. The same is true in relation to job creation in the formal sector. At the very least, the investment climate should be radically improved and this concerns all its multiple dimensions (tax policy and administration, anti-monopoly policy, removing administrative barriers for new business entries, protection of property rights, better law and contract enforcement, etc.).

The major idea of labour market reform could be in replacing the institutional foundations of low wages and rigid employment policy with

institutions that support robust wages and flexible employment policies. The EPL needs further deregulation, while the law and contract enforcement must be radically improved and strengthened. The later assumes strengthening the voice of workers, including activating the role of trade unions and judicial reform, among other measures. Wage-setting machinery needs to be reformed in order to allow the competitive labour market to set wages while individual employers should become price takers but not wage setters. The minimum wage legislation also needs to go through a significant reshuffle. The minimum wage setting should be regionalised and depoliticised, and then the minimum wage could be raised in most of the regions. This will bring needed rigidity into wage setting and will contain extra wage flexibility. The wage-setting reform will require radical changes in the budgetary funded sector of the economy, which has been working so far as a wage-containing anchor. All this will also bring more transparency into labour market functioning.

The public employment service (PES) could improve the transparency of labour market signals, but it should focus mainly on collecting and disseminating job vacancies information, and on job brokering and counselling, while emphasis on job training and subsidised employment cannot be efficient under very low job creation and low PES targeting capacity. Given all the administrative and financial constraints, it would be wrong to expect the PES to deliver much more.

The radical labour market reform involving EPL deregulation and far-reaching changes in the wage-setting machinery across the economy presents a very ambitious agenda. It cannot be accomplished in one jump and requires well-planned politics and thoroughly phased policy. However, the urgent need for this type of reform is the major conclusion I can draw from the short analysis presented above.

V – How to approach the challenge of reconciling labour flexibility with job security and social cohesion in Turkey¹

Hakan Ercan and Aysit Tansel, Senior Lecturer and Professor of Economics at the Middle East Technical University, Ankara (Turkey)²

Introduction

The first objective of this paper is to provide a concise description of the institutional background to labour flexibility and job insecurity in Turkey. Our analysis will then set the stage for long-term labour policy recommendations, in light of the recent labour market reforms, which have mostly been prompted by the EU accession process in Turkey.

The importance of the topic is self-evident in that labour flexibility is implicitly or explicitly associated with economic growth performance. The link between the two was strengthened in the volatile global economic environment of the 1990s, the decade of free-flowing capital of both the direct investment and the portfolio investment varieties. With the newly established financial links, regional crises are now more contagious and spread across continents among the emerging market economies. The frequency of crises that have a large or small global impact has apparently increased.

Under these economic conditions, what then is the optimal balance between the economic need for flexibility and the individual worker's need for job security? The concept has been important in Europe for some years now and is referred to as flexicurity. Not being collectively or historically inclined to condone the American model of flexible labour market institutions and relatively weak employment protection, Europe has been developing the concept of flexicurity.

Turkey's recent economic experience, marked by numerous global and domestic crises, chronic high inflation and IMF-supported stabilisation

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1. Contribution by the Turkish group of experts at the Council of Europe 2005 Forum on Reconciling Labour Flexibility with Social Cohesion.
 2. hercan@metu.edu.tr; atansel@metu.edu.tr.

programmes, the last of which seems to have finally succeeded at great social and political cost, provides ample motivation for this paper. Economic growth came after years of hardship and it came without jobs. Flexibility, leading to falling real wages and job losses, including in the informal labour market, emerged as the clear winner, despite the protective laws, which have not been or could not be applied. In 2001, Turkish university graduates in the financial sector became unemployed *en masse*. This was unprecedented for such a highly educated segment of Turkey's workforce.

The impact of the severe crisis on the social psyche and on recent university graduates is still being felt. Starting and re-entry wages have fallen. Many do postgraduate degrees, removing themselves from the labour force. Despite these developments, the employment level has only recently increased.

This, therefore, is a good time to be discussing flexicurity in the Turkish context. Daily economic debate has not yet caught up with the term, but it soon will. So now is the time to take stock, in the light of a few previous related studies, of the issues currently being debated by management and labour as well as selected labour market statistics.

The authors hope to contribute to the Turkish debate, firstly by systematically introducing the flexicurity angle into discussions on the issue of the informal economy, and secondly by thinking out loud about flexicurity instruments that would be appropriate, feasible and useful for Turkey. Being labour economists, the authors have essentially confined themselves to labour-flexibility and labour-policy recommendations. Although part of this may pass as "social policy", the authors will say nothing about family policy, leaving that to the real experts.

The rest of the paper is organised as follows. Section 1 discusses labour market developments in the context of recent crises and stabilisation programmes. It provides the necessary background as to why the new labour act turned out the way it did. Section 2 discusses labour flexibility and job security in light of the recent labour market reforms. Section 3 concerns informal employment, which bears out the argument that legally rigid labour market regulations do not necessarily imply compliance. Section 4 discusses path-dependent institutional and structural obstacles to reconciling flexibility with social rights. Section 5 concludes with recommendations.

1. Recent labour market developments

Turkey's growth performance was very good in 2004 at 9.9% and 2003 was also a high-growth year. Year-end inflation targets of 12% for 2004 and 8% in 2005 were reached in spite of oil price increases. Turkey suffered major financial crises in 1988, 1994, 1999 and 2001. Its recent recovery started in 2002. Private consumption is the major contributor to this recent surge in growth. Pent-up consumer demand from 2001 and 2002 was not released in 2003 but started to come on stream in 2004. The boom was fuelled by falling interest rates on consumer loans. Economic growth failed to generate employment growth, however. In 2004, the overall unemployment rate was 10.3%. Public-sector employment, which constitutes 13.1% of total employment, kept falling as well: it was 9.5% lower in 2004 than in 2003.

1.1. Jobless growth

The effects of economic recovery and jobless growth prompted a heated public debate. Employer organisations were quick to criticise the new labour act (2003), which replaced a decades-old one. The job security clauses (which amount to a firing tax on employers) were blamed for employer reluctance to expand employment. The applicability of job security clauses is rather limited, however (see the next section). Moreover, the new labour act provided, for the first time in Turkey, for flexitime and regulations on flexible working. These were strongly opposed by the trade unions, which vehemently countered the employers' job security argument, saying, "Now you have all the flexibility you wanted for decades, and you have still failed to create jobs."³

The specific reason for the lacklustre employment performance from 2002 to 2004, however, is a partial labour-productivity increase (Ercan, 2005). Productivity has been improving in the Turkish private manufacturing sector while real wages have been going down. Almost two years into the macroeconomic recovery, employers started hiring again after investing in equipment and machinery. This observation has been borne out by increasing capital goods imports, an indicator of future production and productivity increases.

3. From a speech in April 2005 by Salim Uslu, leader of one of the three major trade union confederations, Hak-Is (the other two being Türk-Is and DISK).

The recent rise in labour-productivity levels (7.5% in the first half of 2004 from a 2001-03 average of 6.3% per annum) must be what is keeping inflationary pressures at bay despite the rise in consumer demand. Average annual private-sector labour-productivity growth during the 1990s was 2.3% (Ercan, 1999). These figures may herald a new figure for the trend in productivity. If so, Turkey's long-term potential growth rate may rise as well. This will bode well for future employment, but Turkey has just gone through a period of increased social exclusion because of poor employment creation performance. There has been a crucial negative effect on public debate and the social psyche. Inflation has lost its decades-long status as the number one economic problem in public opinion polls on unemployment.

As it is, we are not now in a position to assess the impact of the new labour law. Now that employers have started recruiting again, labour economists will, in another year or two, be able to make a preliminary assessment of the law's impact on the labour market. Because of the recent productivity increase factor, it is not yet possible to discuss whether the new labour law had the right mix of flexibility and job security, in other words "flexicurity", for Turkey. "Activation" issues and the social cohesion debate in connection with the flexicurity mix will have to wait their turn.

Nevertheless, we can consider providing an interim assessment. In the second half of 2004, employment started to grow and 644 000 new jobs were created. The State Institute of Statistics (SIS) reported that the number of people not registered (see section 3) increased from 51.7% to 53% of the total workforce from 2003 to 2004. Most of these are unpaid agricultural family workers. In urban areas, 37% of all workers do not belong to a social security scheme. These figures imply that only 30 000 out of the 644 000 new jobs were registered with social security. The new labour law introduced flexitime regulations and flexible modes of employment, citing the need to create formal jobs rather than have a large informal employment sector. If the labour act's performance was to be judged by 2004 data alone, the picture would not look nice.

1.2. Labour markets

It should be borne in mind when considering the Turkish data that there is a dichotomy in the labour market. A large formal private sector and the public sector constitute the primary segment. In urban areas, 37% of those who work have no social security coverage. They constitute the secondary segment of the labour market. It is usually thought that labour

market adjustments during the frequent crises took place in this flexible, informal segment of the labour force that lacks job security. The State Institute of Statistics (SIS) Household Labour Force Survey (LFS) reports that 40% of non-agricultural employers and the self-employed are in the informal sector. Agriculture's share of total employment is high (35%) in Turkey. Because of unpaid family workers, participation and employment levels are high in agriculture, and this favourably affects the overall figures. To be meaningful, comparisons with the EU should thus be made with urban non-agricultural labour market statistics.

SIS has recently revised its data collection methodology to bring it into line with EUROSTAT norms and standards. Its survey now covers 37 000 households, up from 23 000 previously. It has also doubled the number of questions from 47 to 98, fine tuning its classification of employment and unemployment. The most significant departure from previous practice concerns unpaid family workers. This blanket category covered all rural agricultural household members, who were considered to be in employment by default. Casual workers (those on a daily wage) and unpaid family workers must now have worked for at least one hour in the reference week in order to be considered employed. Note that this is an ILO norm and that the EUROSTAT norm is closer to the previous SIS practice. In 2004, total employment was 22.2 million; the number of unemployed was 2.27 million. The total labour force participation rate (LFPR) was 49.2%, which is very low compared with the EU countries. A snapshot of employment is provided in Table 1 below.

Table 1 reveals the general structure of employment. Women entrepreneurs are rare and the male self-employment rate is 2.5 times the female rate. Half of all women are unpaid family workers and 59% of women work in agriculture. Agriculture's share of total employment is large at 35%. Industrial employment has been stable at around 18% for some time. Construction was still at an all-time low at 6.5%. In good periods it climbs to 12%. In 2005, residential construction and employment made a relative comeback.

Table 1 – Employment by economic activity, gender and job status in 2004

	Total employment		Male employment		Female employment	
Job status	22 188	100%	16 212	100%	5 976	100%
Wage/salary	9 114	41.1	7 244	44.7	1 870	31.3
Casual wage	1 949	8.8	1 577	9.7	372	6.2
Employer	1 001	4.5	959	5.9	42	0.7
Self-employed	5 476	24.7	4 903	30.2	573	9.6
Unpaid family	4 648	20.9	1 529	9.4	3 119	52.2
Economic activity	22 188	100	16 212	100	5 975	100
Agriculture	7 820	35.2%	4 307	26.6%	3 512	58.8%
Industry	3 961	17.9%	3 217	19.8%	744	12.4%
Construction	1 073	4.8%	1 053	6.5%	20	0.3%
Services	9 334	42.1%	7 635	47.1%	1 699	28.4%

Source: SIS Labour Force Survey results.

2. Legal flexibility, job security and labour market and welfare-state reforms

The process of EU accession has provided strong incentives for various institutional changes in Turkey. Labour market regulations and employment policies have been one of the most important areas for Turkey in the adoption of the EU *acquis*. The recent changes in the Turkish labour code will alter the functioning of the labour market significantly, with crucial consequences for workers, firms and long-term economic performance.

What makes the new labour act original as far as Turkey is concerned is that it finally provides for flexibility and atypical forms of employment in accordance with the Community *acquis*. Such arrangements were not recognised in the previous labour law. It should be noted that these changes met with union opposition.

Prior to the new labour act, Turkey had rigid employment protection schemes and no legally regulated flexible working arrangements. This was one of the factors contributing to the flourishing informal employment arrangements. Employers demanded flexible employment regulations. Trade unions were hostile to the proposal as they claimed that such

arrangements would worsen working conditions and reduce unionisation rates (which were on a downward spiral anyway).⁴ A balance had therefore to be struck between the aims of making companies more competitive and productive through flexible forms of employment and satisfying workers' demands for job security. This is the very same dilemma facing Europe.

This section of the paper concentrates on regulations concerning labour market flexibility and job security. Section 2.1 will give an overview of recent developments in Turkish labour law. The legal framework for labour market flexibility will be covered in section 2.2 and the legal framework for job security in section 2.3.

2.1. The new Labour Act

The new Labour Act has been in the making for some years. It was written by a set of academics (appointed by the government, employers' organisations and trade unions) and the process involved extensive debate and feedback from management and labour. Employers are generally content with the law except for the job security regulations and the continued existence of severance pay (in spite of the recently institutionalised unemployment insurance scheme). Trade unions see these two points as what they have gained in the process.

The new law's innovative feature is the formal introduction of new modes of employment by means, for instance, of regulations governing part-time work and provisions for flexible working hours (or, in some cases, official acceptance of existing practices). The new code purportedly seeks to bring national labour market practices into line with policy developments and priorities at EU level.

Recent crises and the ensuing unemployment problem led policy makers to give in-depth consideration to new possibilities as regards working time and employment arrangements. As mentioned above, prior to the new labour act, Turkey had rigid employment protection schemes and no legally regulated flexible working arrangements. There was intense lobbying by both the trade unions and employers' associations. Since economic growth came after years of hardship and came without jobs, there were new restrictions on employee dismissal for larger establishments (previously

4. In 2003, public-sector collective bargaining concerned 420 000 blue-collar workers. In 2005, the bargaining process covered 385 000 workers.

benefiting union members only), and severance pay remained as a labour market institution. In addition, trade union lobbying brought satisfactory results as far as the unions were concerned, as the suggested regulations governing temporary employment agencies were revised in their favour. The employers' lobbying obtained satisfaction as far as they were concerned, as increased job security was limited to establishments employing 30 or more workers. It should be noted that over 90% of manufacturing-sector establishments, not to mention firms in the trade and services sector, operate below this level. It may be argued that the flexibility argument has prevailed over job security (further discussion and justification for this will follow in the next section, on informal employment).

The new Labour Act (No. 4857) came into effect on 10 June 2003. It replaced Law No. 1475, which had prevailed for decades. The Job Security Act (No. 4773) was passed before the general election in November 2002 and became effective on 13 March 2003. It was later absorbed into the new Labour Act. The job security act was of course part of the new labour legislation, but it was deemed expedient at the time by the government to pass a separate law, in its own right, just before the elections (the government coalition parties disappeared in the election nevertheless). The ILO convention concerning termination of employment was the model for the Job Security Act, which increased protection against dismissal by improving on the previous labour act and the existing unions act. The Job Security Act was severely criticised by the Turkish employers' confederation (TISK) for having gone too far in protecting workers against dismissal and placing the burden of proof on employers.

2.2. Labour market flexibility under the new Turkish law

This section discusses the flexitime and flexible working arrangements under the new Labour Act (No. 4857).⁵ Employers favour flexible working arrangements, while trade unions oppose deregulation, flexibility and privatisation. There are no regulations in the new Labour Act covering home workers, domestic workers and unpaid family workers.

5. Further details may be found in Süral (2005b) and TISK (2005).

2.2.1. Working-time flexibility

Flexitime

Employer associations demanded greater flexibility in terms of working time, so as to be able to abolish overtime and thus reduce labour costs. Trade unions are against the introduction of flexitime practices. Section 63 of the law stipulates that normal weekly working time may not exceed forty-five hours. This total must be distributed over the working week in such a way as not to exceed eleven hours a day. The distribution has to be even over the working week unless otherwise agreed. Deviations are allowed: reference periods make flexibility possible. Regular work can be increased or decreased as long as the average time worked over two or four months is as stipulated. These flexitime arrangements are not used much in practice. The reason for this is that the distribution of working time over the working week is left to the worker and the employer to agree. Flexitime arrangements cannot be introduced unless both parties are willing. In the informal sector or smaller establishments (the two are usually synonymous), flexitime is the norm anyway.

Compensatory work and short-time working

Compensatory work may be undertaken by workers within a two-month period to compensate for work stoppages that come about for compelling reasons, the extension of national or public holidays and leave granted to the worker at his or her request. Compensatory work cannot be considered as overtime work and cannot be performed during rest days (all workers are entitled to an uninterrupted rest period of at least twenty-four hours in a given week).

In the case of short-time working arrangements, there is a temporary decrease in working time in order to prevent imminent lay-offs. Section 65 stipulates that the establishments must be in distress because of a general economic crisis or for other compelling reasons rather than because of difficulties connected with the establishment itself or a sectoral crisis. Employers operating a short-time working arrangement have to declare the situation and the reasons for it to the employment office and the trade union. Workers on short time are considered to be employed, however, and they receive short-time work benefits from the unemployment insurance scheme if they qualify. The short-time work period may not exceed three months.

2.2.2. Flexible employment arrangements

Flexible employment arrangements, which are also referred to as atypical work or non-standard work, include part-time employment, fixed-term contracts and temporary employment. Employers favour flexible working arrangements. Trade unions, on the other hand, are against deregulation and flexibility. Flexible working arrangements make it easier for establishments to hire workers, particularly women, first-time job-seekers, pensioners and people with disabilities. It is known that part-time work may make it possible to combine work with family responsibilities, thereby increasing the labourforce participation of married women.

Fixed-term contracts

A fixed-term contract is an employment contract which ends for an objective reason, such as the arrival of a specific date or completion of a specific task. Sections 5 and 12 stipulate that fixed-term workers must not be discriminated against on the grounds that they have fixed-term contracts and that they must be treated in a similar way to comparable permanent staff unless differential treatment is justified on objective grounds. It is not possible to renew fixed-term contracts unless there is a strong reason for doing so. This rule is designed to prevent misuse in the form of successive fixed-term contracts.

Part-time work and on-call work

A part-time worker's normal hours of work are substantially shorter than the normal hours of a comparable full-time worker. Sections 5b and 13/2 stipulate that part-time workers must not be discriminated against because they work part time and that they must be treated in a similar way to comparable full-time workers unless differential treatment is justified on objective grounds. Section 13/4 stipulates that employers should take account of demands by workers to transfer from full-time to part-time work and vice versa if this is possible in the firm.

Section 14 regulates on-call work. On-call work is part-time employment whereby a worker is called in to work when there is work to be done. The duration of work is twenty hours a week unless otherwise specified by the parties. The worker must be called on at least four days prior to the day on which he or she is to work. The duration of work has to be at least four consecutive hours in a day unless otherwise specified by the parties.

Temporary employment

In a temporary employment relationship, a user firm, a temporary employment agency and the temporary worker are involved. The agency acts as a mediator. The worker has a contract with the agency rather than with the user firm. The agency sends him or her to work for a user firm in need of additional workers. During the negotiation phase, the proposal concerning this form of employment elicited considerable opposition from the trade unions and the opposition party. In the end, its scope was changed. Section 7 stipulates that employers may hire out their workers to another workplace for six months at the most, to do a similar job. This arrangement is renewable only twice and is referred to as temporary work.

2.3. Job-security regulations

It should be noted that all of the following schemes are for the formally employed and benefits are of the defined contribution-defined benefit variety. There are no means-tested social transfer programmes for the needy in Turkey. The poverty survey by the State Institute of Statistics (SIS) in 2002 identified the (socially excluded) poor as non-working (rural) women, uneducated (unskilled) members of the labour force across all age groups and both genders, and casual workers paid by the day who were not covered under any social security scheme.

2.3.1. Employment termination⁶

Termination by the employer after a period of notice is subject to two set of rules: one for workers who enjoy enhanced job security and another for workers who do not. Enhanced job security is provided for workers employed under an open-ended employment contract. They must have been working for a period of at least six months in an establishment where at least 30 workers are employed. The employer must give notice of dismissal in writing. Section 17 stipulates observance of a period of notice when an employment contract is terminated. The length of the period of notice depends on the length of service in the firm. If the length of service is less than six months, the corresponding notice period is two weeks; if the length of service is between six months and one and a half years, it is longer, and so on up to eight weeks. These are suggested minimum periods of notice. They can be increased by individual or collective labour

6. Further details of employment termination practices may be found in Sural (2005a), TISK (2005) and Tunali et al. (2004).

agreements. If employers do not observe the period of notice, they have to pay compensation.

Unlike an open-ended contract, a fixed-term employment contract ends on a specific date, when a specific task is completed or a specific event occurs. Fixed-term labour contracts cannot be renewed. In the event of renewal, they will be reclassified as open-ended employment contracts. Expiry of a fixed-term contract is the second mode of contract termination.

The provisions governing workers without enhanced job security are designed to avoid impeding the growth of, and job creation in, small- and medium-sized companies. Under Section 17, a worker who is not covered by enhanced job security provisions may be dismissed for any reason or for no reason at all. The employer is not legally obliged to state the reason for the worker's dismissal. However, the employer may not dismiss the worker unfairly. On the other hand, the burden of proof of unfair dismissal will be on the worker. The worker will be entitled to severance pay if he or she has been in the service of the employer for at least one year.

The enhanced job security provisions provide that an employer may not terminate the employment of a worker unless there is a valid reason related to the capacity or conduct of the worker or the operational needs of the workplace or work. The employer has to specify the reason for termination clearly in writing. The worker must be provided with an opportunity to defend himself or herself against the assertions made. The worker may apply to the labour court within a month of receipt of the written notice. He or she may claim that no reason for termination has been given or that the reason specified is not valid. The burden of proof is on the employer. However, the burden of proof lies with the worker if he or she asserts that termination is based on another reason. Section 21 stipulates that the court or the arbitrator may declare the termination invalid and order reinstatement of the worker. If the worker is not reinstated, the employer will be ordered to pay adequate compensation amounting to four to eight months' wages.

Section 25 regulates dismissals with just cause and applies to both open-ended and fixed-term employment contracts. In this case, there is instant termination and no period of notice is required. Examples of just causes are health reasons, serious misconduct and immoral behaviour on the part of the worker (under these conditions the worker may not demand severance pay), other compelling reasons and absenteeism due to the worker's being detained or arrested.

2.3.2. Severance pay

Severance pay used to be very important in the Turkish labour-relations system because there was no unemployment insurance system before 1999. There were debates as to whether severance pay should continue to be provided as in the past once the unemployment insurance scheme had been established. However, there were no amendments to the existing system in the new Labour Act. Section 14 of the previous labour act on severance pay is still in force. The provisional Section 6 stipulates establishment of a severance pay fund. Until the severance pay fund is established, section 14 of the old labour act will regulate the worker's right to severance pay.

Severance pay is a lump-sum payment made to a worker if he or she has worked for at least one year and if his or her employment contract is terminated in accordance with specified conditions. These conditions are as follows: death of worker; worker's compulsory military service; old age pension, retirement, disability benefits; female worker's giving up her job to get married; termination of employment on the part of the worker for a just cause under section 24; and termination of employment by the employer except on grounds of serious misconduct and immoral behaviour and termination of employment on the part of the worker upon completion of the social insurance period required for an old-age pension even though he or she has not reached the prescribed age.

Severance pay amounts to thirty days' pay for each year of service in the workplace in question. The thirty-day specification can be changed by individual or collective agreements. Severance pay is based on the worker's last daily gross wage. Wage supplements of a continuous nature are added to this amount. There is a ceiling on severance pay: the annual amount may not exceed the amount of the retirement bonus of the highest-ranking civil servant, who is undersecretary to the prime minister.

2.3.3. Unemployment insurance scheme

Law No. 4447 governing unemployment benefits is dated 25 August 1999. Payments began in March 2002. Insured workers who lose their jobs benefit from the unemployment insurance system, but not civil servants or the self-employed. Their loss of income is compensated for in proportion to the contributions paid. Section 50 stipulates that the amount of compensation is 50% of the net daily income of the worker. It may not exceed the net minimum wage for workers over 16 years of age. In order to be eligible for unemployment benefits the worker must have been working as an insured

worker for at least six hundred days during the three-year period preceding termination of the contract and must have been working continuously, paying contributions, for at least one hundred and twenty days prior to contract termination. The worker must register with the Turkish Employment Office in person, expressing a readiness to undertake a new job.

Contract termination must fall into one of the following categories: dismissal by the employer with notice or for a just cause except in the case of serious misconduct or immoral behaviour on the part of the worker; resignation for a just cause or on expiry of a fixed-term contract; and redundancy because of privatisation. The duration of payments depends on the length of service and the contributions accumulated. Those who paid contributions for six hundred days in the previous three years are eligible for benefits for six months; payment of contributions for nine hundred days in the previous three years increases eligibility for benefits to eight months and those who paid contributions for one thousand and eighty days in the previous last three years receive benefits for ten months.

In addition to these payments, the unemployed may also receive health and maternity insurance coverage, vocational training, vocational development and retraining services and help with searching for a job. These services are provided by the employment office. The social insurance institution (SSK) is the body responsible for collecting unemployment insurance contributions. A committee consisting of employer, employee and treasury representatives and headed by the director general of the employment office manages the unemployment insurance scheme.

It soon became obvious that far too few workers could meet these stringent eligibility requirements. The fund grew much faster than the benefit payments. A parliamentary committee is currently considering an amendment designed to relax the eligibility criteria and increase benefits.

2.3.4. Compensation for loss of job in privatised establishments

The Privatisation Act (No. 4046) of 24 November 1994 regulates compensation for loss of work in the case of workers in the privatised state-owned enterprises. Section 21 stipulates that compensation for loss of work is an additional payment and does not replace any of the other compensation schemes. It is paid out of the privatisation fund. The worker must register with the Turkish Employment Office in person and must not be receiving social security benefits. Registration also serves as an application for unemployment benefits. Compensation for loss of job compensation is equal to the daily net wage. It is payable for ninety days if

the person in question had been employed for an uninterrupted period of at least five hundred and fifty days at the time of termination, for one hundred and twenty days in the case of an employment period of at least one thousand one hundred days, one hundred and eighty days in the case of an employment period of at least one thousand six hundred and fifty days and two hundred and forty days in the case of an employment period of at least two thousand two hundred days. The redundant worker also receives help with finding a new job, training to acquire new skills and occupational guidance. This is one of the few active labour market policy schemes in existence in Turkey.

3. The informal sector: an undesirable labour market adjustment mechanism⁷

The previous section described the labour market institutions as they pertain to formally established big companies, the first segment of the economy. Manufacturing firms in this segment account for the bulk of Turkey's exports. In this section, another segment is described. Note that the informal (unregistered) economy does not necessarily concern small and clandestine undertakings. In many otherwise formal establishments, it is common practice to register workers at the minimum wage and provide additional compensation in the form of so-called "envelope wages". There is also the practice of subcontracting. Large formal establishments, confronted by global competition, subcontract to firms that employ unregistered workers, in order to reduce costs and gain in flexibility. The wage burden is high in Turkey. Net pay is about half of the gross wage and only 40% of net take-home pay in large formally established private manufacturing companies is related to actual hours worked. The rest is a fixed overhead. This set-up, discussed in section 1 above, and the following discussion of the informal economy, reveal the drawbacks in terms of social inclusion.

7. This section draws liberally on Ercan (forthcoming).

The European Union concept of “undeclared work”⁸ is very close to the Turkish concept of *kaçak işçilik* (literally, clandestine or illicit workmanship) or *kaçak çalışma* (clandestine or illicit labour and work). The extensive national debate on this topic distinguishes between undeclared work and “informal (unregistered) employment”. The latter term is used to describe those workers who are not known to the authorities. All informal employment is therefore undeclared work, but the full scope of undeclared work is wider than just unregistered employment. Criminal activities are excluded from the concept of undeclared work.

Because of the frequent economic crises in recent years, discussed in section 1, and the resulting austerity measures sanctioned by the International Monetary Fund (IMF), the employment performance of the Turkish economy has not been satisfactory. The recent macroeconomic recovery has not brought about an increase in jobs. The phasing out of agricultural subsidies and large regional disparities in income are likely to bring about another wave of rural-to-urban migration.

Given the lack of marketable skills (in particular the low levels of education) of most Turkish workers, the working environment is conducive to unregistered work. Non-compliance with the rules allows for flexibility (minimal hiring and firing costs) in the case of unskilled workers in low added-value, low-productivity activities such as working from home in the garment industry and the production of brand-name clothing in small firms. The smaller the firm, the less likely it is to comply with labour and tax regulations. Larger firms may register themselves but not all of their workers. Many registered employees receive “envelope wages” in cash over and above the statutory minimum wage. This arrangement is also commonly found in central and eastern European states. This type of fully or partially undeclared work probably accounts for the bulk of the phenomenon in Turkey.

Measures to combat undeclared work are only weakly enforced in Turkey. It is illegal for employers to hire workers without social security coverage. There is a fine applicable to the employer, which can amount to three

8. The concept is defined in the 1998 Commission communication on undeclared work and is often quoted in later related EU documents. “The concept of ‘undeclared work’ is taken to mean any paid activities that are lawful as regards their nature but not declared to the public authorities, bearing in mind differences in the regulatory system of Member States. Applying this definition, criminal activities would be excluded, as would work which does not have to be declared.”

times the monthly minimum wage for each worker not covered. However, compliance with the law is rather poor because of the low probability of being caught by the inspectors. Furthermore, before general elections, it is almost customary for the incumbent government to grant an amnesty to employers guilty of unpaid social security contributions and relieve them of the fines in question. In February 2006, once again, an amnesty proposal is on the parliamentary agenda. So why should anybody comply?

A close reading of existing studies and their methodologies suggests that a conservative estimate of 20% is a realistic minimum for the unregistered economy, putting Turkey in the same league as Greece and Italy. The real figure is more likely to be over 30%, which puts Turkey closer to Bulgaria and Romania. The true figure may be even higher: employers and trade unions often quote the unregistered economy as being half or two thirds the size of the legal economy. However, the methods they use are not well documented, if at all.

Note that, on paper, Turkey has rigid employment protection regulations, almost as tight as Portugal's. By now, it must be clear that in practice the picture is different. Such a segmented labour market makes for an undesirable form of flexibility, that is, an employment relationship where there is no job security or social security coverage. Informal-sector jobs not only pay less and fail to provide retirement and health benefits, but also lack a number of desirable non-pecuniary attributes such as job security, an employment contract, paid holidays and leave as well as other fringe benefits. Informal-sector workers are more likely to be temporary. Informal sector-working environments may also be unregulated and may be subject to poor and unhealthy working conditions.

The social ramifications of working in the informal sector are as is to be expected, and they are severe. Some of the symptoms are weak labour force attachment, low human capital levels that will be perpetuated in the second generation, undesirable working conditions and workplaces that do not provide for such benefits as day care (thereby limiting the already low labour force participation rates of low-skilled married urban women). On the sociological side, mention should be made of low self-esteem and low-income segregated neighbourhoods – overall, a sense of not belonging. This is a dangerous urban mix in cities that receive migrants, such as Istanbul, Ankara, Izmir and Mersin. Rising crime rates in these cities bear witness to this observation.

3.1. Sectoral distribution and scope

The distribution of informal employment in Turkey concerns the usual sectors of a developing economy, such as textile production in the home and in small- and medium-sized enterprises and personal services. A defining (but not exclusive) characteristic of the informal sector is that workers are not covered by any social security scheme.⁹ However, undeclared work occurs across the board because of the Turkish legal code, which exempts small-scale farmers, small-scale vendors and artisans from taxes. All street vendors are also exempt. Vendors and artisans in one- or two-person operations are not covered by employment legislation. The same applies to agriculture.

The output of one third of the total labour force – namely those working in agriculture – is typically non-observable. Almost all self-employment in Turkey is likely to be either unregistered or partially or fully undeclared. This probably also applies to the majority of professionals such as doctors and lawyers; these groups often only declare incomes at the minimum level. In addition, more than half of urban employment is in services. All told, the working environment in Turkey is highly conducive to undeclared work.

The importance of the retail and restaurant sectors in undeclared work is similar to that found in central and eastern European countries. In contrast to these countries' economies, the informal economy has a strong presence in the manufacturing sector. This is because most manufacturing is on a small or micro-scale in Turkey, and textiles are very important in terms of industrial revenue and exports.

The SIS (2000) conducted a survey of the informal sector among small urban enterprises. It reported the following distribution of employment in the informal sector: 20.3% in industry, 58.4% in trade and 21.3% in the service sector. The State Institute of Statistics Household Labour Force Surveys (LFSs) also reports the percentage of workers not covered by any social security scheme. In 2005, 19% of wage earners, 80% of casual employees, 17% of employers, 69% of the self-employed and 98% of

9. In Turkey, the social security system is three pronged. The Retirement Fund, which was established in the 1940s, provides social security coverage for civil servants and military personnel. The Social Insurance Organisation, which was established in 1964, provides coverage for blue-collar workers in public or private enterprises. Bagkur, which was established in 1972, provides social security coverage for agricultural workers and the self-employed.

unpaid family workers (who are predominantly in agriculture) were not covered by any social security scheme. The overall proportion not covered was 51.7%, including agriculture.

The SIS Labour Force Survey reported employment in the informal sector to be 1.34 million (12.5% of urban non-agricultural employment) in 2004. This low figure is the result of the severely restricted definition applied to the concept of the informal sector by the SIS. The informal sector is defined as those non-agricultural economic entities that are unincorporated (personal ownership or simple partnership) and that either pay no taxes or pay a nominal tax according to occupation rather than income. This definition categorically denies the existence of informal employment or undeclared work in formal establishments and does not attempt to measure it. The definition also ignores social security status, which the SIS otherwise records. The SIS Labour Force Survey results in 2004 revealed that 4.5 million non-agricultural workers had no social security coverage whatsoever. This is 30% of the non-agricultural workforce of 15 million.

The situation is not good in terms of quality of life. According to Tansel (2000a), registered wage-earning men earn more than unregistered wage-earning men and the self-employed (excluding professionals and technicians). Among registered wage earners, men's predicted wages are twice women's wages, which may indicate wage discrimination or occupational segregation. Among unregistered wage earners, men's wages are nearly equal to those of women. The genders are equal in terms of poverty.

4. Structural difficulties in reconciling flexibility with social rights

Officials from the Turkish Ministry of Finance and Ministry of Labour routinely speak out against the unregistered economy and undeclared work, the flexible component of the economy. Avoiding taxation and social security contributions creates unfair competition for law-abiding companies, from low-productivity firms to large, formal, unionised businesses in the highly competitive food, textile and clothing sectors. Ministers therefore pay some heed to the problem at meetings with employers' organisations.

However, real inroads into the problem of tax evasion and undeclared activities are hampered by the practice of offering tax or social security amnesties after a number of years of failure to pay. Political parties generally

offer such amnesties ahead of elections. This and other practices such as the underdeclaration of income have undermined public trust in the state authorities' powers to address the problem of undeclared work.

As noted above, one third of total employment in Turkey is in agriculture. Workers in this sector tend to be uneducated and unskilled. When they migrate to urban areas (as agricultural price supports have mostly been phased out), women are not likely to participate in the labour force at first. Younger women go to school or find employment in the textile sector until they get married: this is almost the norm in the sector. Young uneducated men work in the building industry if they can. This means that low-skilled agricultural employment and urbanisation will continue to provide fertile ground for informal employment and undeclared work for at least another decade, and possibly longer, in Turkey. This may be an important reason for the authorities not to crack down on undeclared work. Formal employment-growth performance in Turkey has been very poor in relation to the growth in the unskilled working-age population. The strategy may be one of turning a blind eye to the problem and hoping it goes away. Frankly, this may be an expedient strategy for the time being, until Turkey extends compulsory schooling (from eight to twelve years) and educates its younger population.¹⁰

The second important possible cause of the prevalence of informal employment is the dominance of small- and micro-enterprises in Turkey (State Planning Organisation, SPO, 2001). Low levels of human and physical capital imply low productivity. Exemptions in the tax code and employment legislation for self-employment and micro-firms are conducive to informality in the non-agricultural sector. Surveillance is in any case difficult in small-scale services and manufacturing. The exemptions can therefore be seen as an admission by the state authorities that resources are lacking for effective policing of the system.

The SPO (2001) report states that lenient official attitudes towards the unregistered economy go back several decades. In the process of capital accumulation and providing incentives for entrepreneurs, many tax exemptions were granted and the Turkish private sector mostly developed automatically requesting such preferential treatment. These attitudes are now ingrained, reinforced by frequent amnesties concerning tax and social

10. This is the pragmatic personal opinion of one of the authors, which usually meets with resistance from other scholars. Opponents are correct in the sense that everyone deserves social rights such as decent social security coverage and related benefits.

security payments. The tax collection system has become distorted and is continually being revised and re-revised. The perception of fairness has been sacrificed as governments have routinely collected “supplementary” taxes for one reason or another. Matters will only improve when trust is re-established between the citizens and the government. This will depend on stable macroeconomic conditions.

Finally, employers’ organisations complain about red tape and non-wage labour costs.¹¹ These are both high in Turkey in comparison with OECD averages. The Turkish employers’ confederation (TISK) makes a strong case for simplifying the rules and regulations to reduce the administrative burden on employers. TISK claims that these pecuniary and administrative costs encourage informal employment and discourage entrepreneurship. Law-abiding establishments suffer unfair competition as a result. Trade unions counter with the “wage level” argument. Although only about 40% of the Turkish formal sector payroll cost is accounted for by basic wages, that is pay for actual hours worked (the rest being bonuses and social payments such as social security contributions), the hourly wage cost in Turkey is only a fraction of that in other industrialised countries. In 2003, in the large formal, unionised private sector, the gross hourly wage per worker was 7.1 new Turkish lira (YTL) (\$5.1 at 1.4 YTL/\$ or 3.9€ at 1.8 YTL/€) (TISK, 2004). Even though factually correct, this argument does not, however, take into account cross-country differences in productivity or the fact that the employer would still have a significant wage bill to pay even in times of non-production.

The situation described above has an important effect on productivity. Informal employment and most undeclared work in Turkey are associated with low levels of human capital. Education is found to be an important determinant of formal versus informal choices. Wage earners with more education are more likely to have social security coverage (Tansel, 2000a and 2000b). There are high proportions of people who are illiterate or have no qualifications among unregistered workers in comparison with registered workers. Conversely, there are high proportions of secondary school and university graduates among registered workers in comparison with unregistered workers. A step in the right direction was to increase

11. The website of the Turkish employers’ confederation (TISK) (www.tisk.org.tr) has many bulletins and reports making this case. TISK declared the size of the unregistered economy to be 66% of the registered one in 2003, compared with 40% in 2001. The computational methodology and what accounts for the jump are not discussed in TISK sources.

compulsory schooling from five to eight years in 1997. Note that, given a low human capital base, even if capital investment per worker goes up (and it has been rising since the end of 2003), workers on the shop floor or at the computer terminal will not be able to take full advantage of such an increase. Higher levels of education and training correlate positively with growth and further development of human resources and would help to combat undeclared work and the informal economy, which are concentrated in low-skilled sectors. In turn, this would lead to improvements in social security coverage and to an increase in tax revenues.

4.1. Measures taken to combat undeclared work

Political attitudes to undeclared work are lax, as has been discussed above. Historically, the general attitude has been lenient, and this situation continues today. At the same time, finance and labour ministers are obliged to agree with employers and trade unions that the authorities should crack down on unregistered employment. Some important measures such as unemployment insurance and training programmes for people who have lost their jobs in privatised industries have been introduced to tackle the informal economy and help establish social rights for workers. The list is still a short one.

Given time, measures that are not necessarily aimed at combating undeclared work will eventually contribute to its reduction. To quote from the EC report on undeclared work (2004): "Therefore, in the less advanced of the new Member States and candidate countries, efforts should be targeted at state formation, development of democratic institutions and stabilization of the general socioeconomic situation. Policy targeted towards undeclared work is of later concern." If "state formation" is replaced with "institution building", and "development of democratic institutions" with "strengthening democratic institutions", the same conclusion would be reached for Turkey.

5. Conclusion

The socioeconomic factors fuelling the existence of undeclared work and unregistered employment in Turkey may be reiterated as follows:¹²

- there has been macroeconomic instability and volatile growth. A series of anti-inflationary, demand-contracting IMF programmes has

12. Some points have not been discussed in the text for the sake of brevity. The same layout is followed in Ercañ (forthcoming).

finally reduced inflation and achieved growth, but the recovery has so far been unable to generate jobs;

- a related factor is that the economic environment is not conducive to direct foreign investment, as foreign capital complies with the rules and steers clear of undeclared work (EC, 2004);
- unemployment is still high, and this makes people more willing to accept informal work contracts;
- agricultural subsidies have largely been phased out. Rural-to-urban migration of unskilled agricultural workers may accelerate;
- privatisation has rendered some former public-sector employment less formal;
- Turkey's excessively lenient regulations on retirement age have recently been tightened. However, there is still a young retired population in their late 40s and 50s. They are more likely to engage in undeclared work to supplement their pensions;
- income distribution is highly skewed. The top 20% of households receive half the income. The bottom 20% receive 6%. Poverty is a powerful motivator behind undeclared work.

Institutional factors also contribute to the high level of undeclared work:

- there is a high tax burden on employment and social security contributions are high. The state does not contribute for individuals, but ends up paying the deficit in the form of a lump sum from the budget. The social security deficit already represents 4.5% of GNP, despite favourable demographics;
- tax controls are inadequate. The government has traditionally been unwilling to crack down on small firms, which account for the bulk of employment;
- there is excessive red tape. The Turkish employers' confederation states that 172 signatures are needed to set up a business and the process takes two and a half months. Nor does it end there. This level of bureaucracy tends to impede entrepreneurial activity.

Cultural factors must also be cited:

- people have come to mistrust the tax authorities (and the government). "Supplementary" taxes are the norm, and "temporary" taxes have stayed in place;
- offenders have received too many amnesties for failure to pay tax and social security. This has led to a deep-rooted feeling of unfairness among law-abiding citizens and companies. The state does not just

let the market eliminate inefficient operations, and governments routinely cave in to popular demand. This is detrimental to the business environment in the longer term;

- former agricultural workers are not accustomed to asserting their rights.

Note that almost all of the above points call for policy recommendations. Macroeconomic stability has improved, and this will gradually allow more structural measures to be taken. The EU accession process is expected to increase direct foreign investment, which will make for greater labour law compliance. The main obstacle in the way of social inclusion, however, is unemployment. The only prospect here is a gradual rise for demographic reasons, including rural-to-urban migration. There are no easy solutions. A concerted effort is needed to ensure more basic education and vocational training, more active labour market policies, less bureaucratic red tape surrounding job creation, reasonable tax burdens on employment, and more social welfare measures for the inevitable needy. The likely casualty in this battle will be income equality, as more jobs will usually mean low-quality jobs (in the service sector) that do not pay much.

Not surprisingly, Turkey has so far had little success in tackling undeclared work, revealing a de facto preference for labour market flexibility over social inclusion. Employers' organisations emphasise the importance of tax cuts and reductions in social security contributions, while trade unions call for mandatory unionisation. All these are mostly labour economy approaches, and advocates for disadvantaged groups and sociologists should have a greater say in the debate. Cultural attitudes towards social rights are not sufficiently discussed. Maybe with increased urbanisation and education levels, cultural attitudes will slowly change. Smaller urban families, who are cut off from their extended family and social support structures, are likely to produce individuals who are better equipped to find out about and defend their rights, and who are more demanding in this respect.

As mentioned in the section on jobless growth, the debate on labour flexibility and social cohesion will necessarily have to include the impact of the new labour law. This will take some time, as it is not yet clear whether the newly introduced mix of official flexibility and job security clauses will succeed in expanding formal, registered employment, arguably "the" precondition for social inclusion, in the medium to long term.

Having said that, however, the authors do not foresee a bleaker future in terms of social exclusion. In the analysis, there were references to education and urbanisation. The rural to urban transition facilitates education.

Increased educational standards are more closely associated with employment in the formal sector. It should also be mentioned at this point that Turkey's textile exports, although still the largest form of exports, are losing some of their share to automotive and consumer durables. The textile sector is much more likely to be flexible, informal and unregistered than the two newcomers, which offer better job security and which are much more likely to be formal and registered. Even the now booming informal residential construction sector will serve as an employment buffer for the newly urban, young, unskilled male workers while their brothers and sisters go to school.

Given time, social and working conditions are expected to improve steadily in Turkey. With its proximity and prospective accession to the EU, Turkey may not fully commit itself to pursuing growth at a high social cost (in the form of income inequality and social exclusion) – in so far as costless growth is possible – as it is apparently eager to embrace EU-style social norms. Who knows, it may even have its first means-tested social transfer programme in place in a few years.

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