
SOCIAL AND ECONOMIC PROBLEMS IN CEECs

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Introduction

After the break-up of the communist system, Central and Eastern European countries (CEECs) started chasing after the western part of our continent. This process is still being continued and will be continued for a long time. Some of the countries from our region will achieve the life standard of Western Europe sooner and some of them later because the differences in their economical and social conditions and development perspectives are significant.

The main aim of the paper is to diagnose the current economic and social situation in CEECs. Problems described in the article can be embraced under two headings:

1. Problems of “today”:

- Unemployment
- Human development
- Road to a better Europe

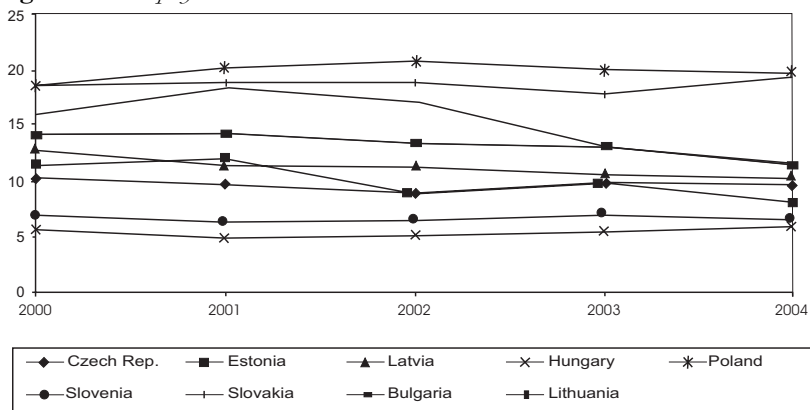
2. Problems of “tomorrow”:

- Pension systems in CEECs—present state and future

PROBLEMS OF TODAY

1. Unemployment

The highest rate of unemployment in Poland was in the years 2000-2004 but at the end of the mentioned period Slovakia showed nearly the same unemployment rate. The indicator in those countries was at a level of 19-20%. Romania, Hungary and Slovenia had the lowest unemployment rate at 6-7%. Bulgaria demonstrated the most significant decrease of unemployment. The unemployment rate decreased in that country from 18.4% to 11.5% in years 2001-2004. The unemployment rate in all analysed countries is shown in Figure 1.

Figure 1. *Unemployment rate in CEECs*

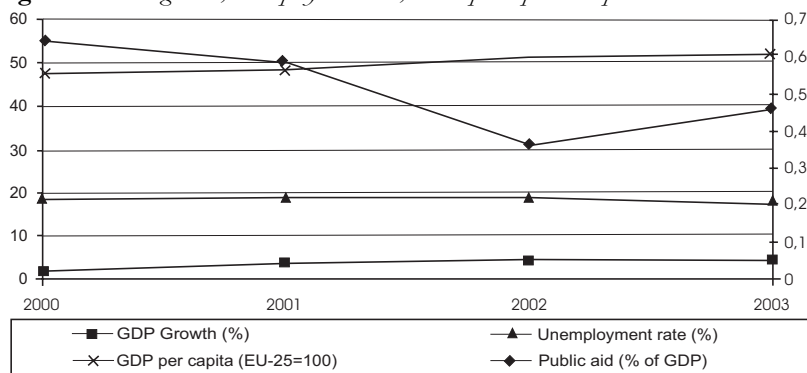
Source: Eurostat

It is worth comparing changes in the level of unemployment and other variables related to the unemployment rate. These are GDP growth and FDI as a proportion of GDP, which stimulate new jobs and influence the unemployment rate negatively. In all analysed countries GDP growth was for the years 1998-2003; only in 1998 and 1999 was negative growth shown in the Czech Republic, Estonia and Lithuania. The lowest value of the two indicators (GDP growth and FDI/GDP) was displayed in Poland and Slovakia, and those countries had the highest unemployment rate, characterized by a positive trend. In Latvia and Hungary, where the GDP growth and FDI/GDP were very significant, the unemployment rate decreased vastly. But in others countries with high GDP and FDI growth, the unemployment rate remained stable (Czech Rep., Estonia, Lithuania). The reason could be the less flexible labour markets in those countries which react weakly to economy growth, which was probably caused by the stiff labour laws.

The most significant cutting of public aid was in Latvia in years 2000-2003 (from 0.54% of GDP to 0.10 % of GDP). At the same time the GDP growth in that country was at the 6-8% level, which resulted in an increase of GDP per capita from 35.2% of average for EU-25 to 40.6%. Poland is the only country where the GDP per capita calculated in comparison with the EU-25 decreased (from 45.9% to 45.6%). It is very important to mark that the highest increase of public aid (1.78% of GDP) was in Poland. The graph of public aid is very

interesting in Lithuania, where the government had a “tender heart” every two years (Figure 2).

Figure 2. GDP growth, unemployment rate, GDP per capita and public aid in Slovakia



Source: Eurostat

A very important problem of contemporary societies is the share of women in the total number of unemployed persons. This indicator is very diverse in CEE countries. The highest value of that indicator in 2003 and 2004 (61.5% and 58.2%) was in the Czech Republic. Estonia is the only country where the number of unemployed women was lower than the number of unemployed men (the value of the indicator was 44% at the end of 2004). When we look at the graphs showing the structure of unemployment in years 1999—2004, we can see that the analysed indicator was increasing very fast in Lithuania (from 44.9% to 52.3%) as well as in Hungary and Latvia. The most significant decline was indicated in Poland (from 56.5% to 52.3%).

The educational structure of unemployment measures which of the selected groups had the highest probability of being unemployed and what the differences of that probability in analysed countries were. We have three education levels:

- lower secondary: includes no education, primary and lower secondary results,
- upper secondary: includes upper secondary and post-secondary but not tertiary qualifications,
- tertiary education: includes tertiary education qualifications.

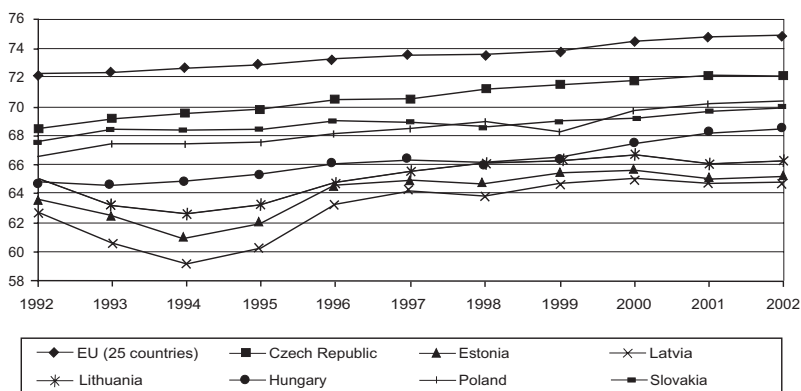
The Czech Republic, Poland, Hungary and Slovakia were the countries in which the unemployment rate for citizens with lower education level was increasing. The highest value of that indicator (48.9% at the end of 2004, the total unemployment rate equal to 19.3%) was in Slovakia. The lowest unemployment rate for the group with tertiary educational level and the highest for the group with lower education level were in each analysed country. The differences between the unemployment in those three groups were very diverse. The much bigger difference between the groups with the second and the third level than between the groups with the first and the second level was in the Czech Republic, Hungary and Slovakia. The opposite situation was in Lithuania, where the more significant difference was between the first and the second level. In 2004, the chance of becoming unemployed was over 12 times higher for the people with lower education level than for people with tertiary level in the Czech Republic. In every analysed CEE country the relative difference between unemployment in the first and the third group was greater than the average for EU-25 (2.4 times higher probability of being unemployed for Level I than for Level III).

2. Human development

Life expectancy at birth is the most objective measure of the quality of life. That indicator for men and women was significantly lower in all analysed countries than it was in 25 EU countries (81.1 years for women and 74.8 years for men), but it was increasing and was proof of an improving social situation in CEECs. Differences in life expectancy in CEECs were significant. The lowest values of that indicator were in Latvia (76 for women and 64.8 for men) and the highest ones were in the Czech Republic (78.7 for women and 72.1 for men). In Poland the life expectancy for women was also 78.7 years. The breakdown of analysed indicators was very interesting in all Baltic Region Countries in years 1993-1995. In that period the life expectancy at birth for women and men decreased in Estonia, Latvia and Lithuania (in Latvia in 1994 72.7 years for women and 59.3 years for men). Life expectancy at birth for women is shown in Figure 3.

The human development index is a composite index that measures the average achievements in a country in three basic dimensions of human development (Human Development Report 2003, Oxford University, New York 2003):

- a long and healthy life, as measured by life expectancy at birth,
- knowledge, as measured by adult literacy rate and the combined gross enrolment ratio for primary, secondary and tertiary schools,
- decent standard of living, as measured by GDP per capita in purchasing power parity (PPP).

Figure 3.

Source: Eurostat

The HDI for CEE countries and for countries with the highest and lowest value of that indicator is shown in Table 1.

Table 1. Human Development Index (HDI) in CEECs and in Norway (the highest HDI value) and in Sierra Leone (the lowest HDI value)

Country	HDI value in 1995	HDI value in 1995	HDI value in 2001	HDI rank in 2001
Czech Rep.	0.835	0.843	0.861	32
Poland	0.794	0.810	0.841	35
Hungary	0.803	0.807	0.837	38
Slovakia	0.836	39
Estonia	0.814	0.793	0.833	41
Lithuania	0.819	0.785	0.824	45
Latvia	0.803	0.761	0.811	50
Norway	0.900	0.924	0.944	1
Sierra Leone	0.275	175

Source: Human Development Report 2003, Oxford University, New York 2003

All CEECs were classified in the high human development group, which includes 55 countries with HDI value greater or equal to 0.800. In this classification limited to CEECs the Czech Republic was the most developed country with a HDI value equal to 0.861 (HDI rank was 32). The least developed country in the analysed group was Latvia (0.811, HDI rank was 50). The Baltic Region Countries (Estonia, Lithuania and Latvia) were the only countries where the positive trend in the time series of HDI broke down in 1995.

3. Road to a Better Europe

If we suppose that all European countries expand at the same tempo as in the last four years, they will achieve the average value of GDP per capita, calculated for EU-25, in the time presented in Table 2.

Table 2. *Time of chasing EU-25 average value of GDP per capita by CEECs*

Country	GDP per capita in compare with EU-25 average	Average tempo of chasing after EU-25 in 2001- 2004	Years
Czech Republic	70.0	2.15	17
Estonia	49.8	3.68	19
Latvia	43.2	5.25	16
Lithuania	47.8	5.76	13
Hungary	60.5	3.36	15
Poland	46.7	0.43	176
Slovakia	52.0	2.29	29

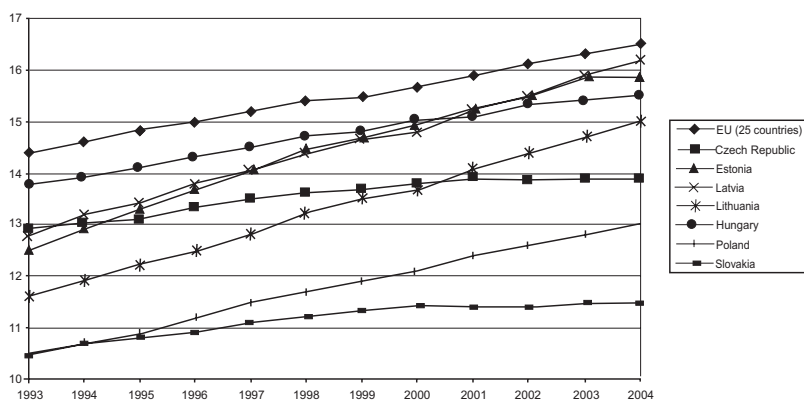
Source: own computation

This perspective is for Poland especially pessimistic. But the distance between Poland and EU-25 increased in 2001 and 2002. Although Poland indicated a higher economy growth in 2003 and 2004 and reduced that distance, the tempo of GDP per capita growth was very low. If Poland were to keep this tempo, it would be chasing after Europe for 176 years. We can only hope that this pessimistic forecast will be not materialise. Taking presented simulation into consideration, all analysed CEECs without Poland will achieve the European GDP per capita level in the next 30 years (Lithuania in 13 years, Slovakia in 29 years).

PROBLEMS OF TOMORROW

The ageing society process is very alarming for many countries. It is also observed in Central and Eastern Europe. But in every analysed country the proportion of population aged 65 and over in the whole population was lower than the average for EU-25 (16.5%). The lowest value of that indicator was in Slovakia (11.5%) and the highest value was in Latvia (16.2%) in 2004. The positive trend of analysed proportion was in all CEECs in years 1993-2004 (Figure 4.) inclusive. This problem is the main reason for reforming pension systems in many countries all over the world.

Figure 4. *Proportion of population aged 65 and over (% of population)*



Source: Eurostat

1. Pension systems in CEECs—present state and future

We have three kinds of pension systems: PAYG, funded and mixed.

PAYG (pay as you go), an unfunded system—contributions paid on social insurances “today” are designed for today’s pensions. This system involves the solidarity between generations because generations working now fund pensions of the old generations.

Advantages of PAYG system:

- resistance to changes on financial markets,
- possible resistance to inflation, but can be non-resistant to hyperinflation because, in the period between inflow of contributions to the system and outflow, pensions from the system can decrease the real value of the money.

Disadvantages of PAYG system:

- lack of resistance to unfavorable demographical trends (ageing society process),
- limited resistance to increase of unemployment rates, which results with a decrease of the sum of contributions paid to the system,
- limited resistance to real wages decrease, which results in lower contributions paid to the system. But this situation should be treated as normal in the system based on solidarity between generations because if the real wages of the generation working “today” are decreasing, the real pensions of older generations should also decrease.

The funded system involves investing money paid to the systems on financial markets. Everyone is responsible for his future pension today because of the ability to make decisions about in which pension fund to invest money.

Advantages of funded system:

- resistance to unfavorable demographical trends (ageing society process)
- resistance to increase of unemployment rate
- resistance to real wages decrease (in a short time) because profits on investment made by pension funds can cover decline of sum of contributions

Disadvantages of funded system:

- no resistance to changes in financial markets
- possible non-resistance to long-term inflation

The mixed system is the connection between two described systems: the unfunded system and the funded system. The one part of money paid to the system is designed for today’s pensions and the second part is invested and expands retirement capital. In this way this kind of pension system integrates the advantages of two previous systems: PAYG system and funded system.

The main reasons for reforming pension systems in CEECs are:

1. Demographic trends and retaliated costs and spending on pensions:
 - population growth will likely slow down (graph) and dependency ratio (proportion of the population aged 65 and over to the population aged 15-64 years) will increase. The PAYG system, which involves paying pensions

from the contributions flowing now to the system, will not be sufficient. The proportion of population paying contributions into the system will decrease and the proportion of population receiving pensions will increase

- life expectancy at birth is still increasing and people receive pensions for a longer time
2. Inefficiency of labour market (unemployment) and its future results:
- high unemployment rate, especially in Poland and Slovakia, which influences the flows to the system negatively

2. In search of an Optimal Pension System—the Three-Pillar Pension System

The reform of pension systems in CEECs is a transition from the PAYG system to the mix system consisting of three pillars:

- mandatory repartition part (I pillar),
- mandatory funded part (II pillar)
- voluntary funded part (III pillar).

This system makes the diversification of the risk through the connection of unfunded and funded part possible because the first is free of many disadvantages of the second and the second is free of many disadvantages of the first. So the main advantages of the three pillar system are:

- diversification of risk related to unfavorable demographical trends; inefficiency of labour markets and changes on financial markets
- the state and the citizens are responsible for the future pension because in the funded part of the system citizens have a possibility to choose the fund which is the institution investing their money
- stimulation of GDP growth by funded pillars in which the contributions are invested on capital markets and can influence the amount of investments
- citizens are able to influence their future pension through choice of institution (pension fund) in the second, mandatory pillar and additionally the investment or insurance product in the third, voluntary pillar. The system is very flexible because everybody can find something for himself, taking his income into consideration.

The main future effect of the pension reform is the fact that predicted pension expenditures will remain stable in the nearest 50 years, although the dependency ratio will increase over two times in this period. It is worth comparing CEE countries with France which has significant problems in convincing its society that a reform of the pension system is necessary (Table 3).

Table 3. *Dependency ratio and pension expenditures in selected CEE countries, in France and in OECD (average)*

	Dependency ratio (in%)		Pension expenditures as proportion of GDP (in %)	
	2000	2050	2000	2050
Poland	20.4	55.2	10.8	8.3
Hungary	23.7	47.2	6.0	7.2
France	27.2	50.8	12.1	15.8
OECD (Average)	23.8	49.9	7.4	10.6

Source: World Population Prospects, United Nations Population Division

Main problems of the pension reform are presented in the example of Poland:

- delayed cash flow from public social insurance institution to pension funds,
- citizens have limited knowledge of finance and pension funds activity and their decisions concerning choice of pension fund are irrational. The criteria which should be taken into consideration (rate of return, assets of the pension fund, contributions for the management) are not correlated with the decisions. This behavior of citizens does not induce pension funds to the competition in the field of the effects on investments. Pension funds have

very similar investment portfolios and because of that their rates of return are not significantly different. In this way the funds reduce the probability of not achieving a minimal required rate of return and the need of covering shortage of assets. Open pension funds in Poland compete especially through advertisement policy because the results of research show that people choose funds that spend more money on advertising.

Conclusion

Attempts by the CEE countries to solve their many important social and economic problems is the price which should be paid for chasing after Western Europe. The begun reforms give effects very late and societies incur their costs. The privatization process often results in high unemployment, which is the biggest problem in our region. The ageing society process is the main reason for reforming pension systems. However, CEE countries along the “road to better Europe” success have clearly specified aims. One very important one was achieved in 2004, when those countries acceded to the European Union. The next aim, still to be realised, is the convergence in living standards with Western Europe.